

## Kovan Engineering (Aust) Ltd v Gold Peg International Pty Ltd

- The importance of pegging down key terms of an agreement in writing

Often in the commercial world, parties rely on a common understanding or the otherwise inadequate protection of a handshake (or even a “shrugging” of the shoulders) rather than take the time to formally document the terms of an agreement. The recent decision of the Full Court of the Federal Court of Australia in *Kovan Engineering (Aust) Ltd v Gold Peg International Pty Ltd* illustrates why this is not a good idea.

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### BACKGROUND

The case concerns alleged agreements between various parties for the manufacture and supply of an industrial direct steam-injection-cooking machine (*the DSI cooker*). Robert Smith (*Smith*), an experienced dairy and food technologist, designed a machine to make processed cheese and other “pumpable food products”, and first prepared some sketches of the DSI cooker in the early 1980’s (*the original drawings*).

Smith then approached the global Alfa-Laval Group of companies (*the Alfa-Laval Group*) in 1984 to further develop and manufacture the DSI cooker. In 1986, Smith signed a consultancy agreement with a Danish subsidiary of the Alfa-Laval Group (*the consultancy agreement*) under which Smith assigned all rights in the DSI cooker (including Smith’s copyright in the original drawings). Within months, the Alfa-Laval Group informed Smith that it would not proceed with manufacturing the DSI cooker, but encouraged Smith to pursue its development with the Alfa-Laval Group’s Australian subsidiaries. The Australian subsidiaries agreed to further develop the DSI cooker and under Smith’s supervision, developed further engineering drawings of the DSI cooker (*the Alfa-Laval drawings*).

The Alfa-Laval Group then commissioned Kovan Engineering (Aust) Pty Ltd (*Kovan*) to manufacture the DSI cooker. A successful prototype was developed, and a DSI cooker was manufactured and installed at the premises of Bonlac Foods Ltd in 1989. Despite these successes, the Alfa-Laval Group failed to commit to the future manufacture of the

DSI cooker. Smith ultimately ended the consultancy agreement with a letter to the Alfa-Laval Group in 1992. In the letter, Smith sought confirmation of “the mutual cessation of the [Consultancy] Agreement” and the return of all “previously assigned rights”. An officer of the parent company of the Alfa-Laval Group countersigned the letter, supposedly confirming the end of the consultancy agreement and assigning all rights in the DSI cooker to Smith’s company, Gold Peg International Pty Ltd (*Gold Peg*). (Incidentally, the trial judge found that the officer who had countersigned the letter on behalf of the parent company had actual or apparent authority to end the consultancy agreement and assign the rights in the Alfa-Laval drawings developed by the Australian subsidiaries. This was so despite Smith originally assigning the rights in the DSI cooker to the Danish subsidiary, and despite the Alfa-Laval drawings being developed by the Australian subsidiaries. It would seem that, in the circumstances of this case, the trial judge was prepared to find that the parent company had power to assign rights owned by its subsidiaries.)

It transpired during the trial that the impetus for the breakaway from the Alfa-Laval Group was not just the Alfa-Laval Group’s failure to commit to the future manufacture of the DSI cooker. Smith was looking to go into business using Gold Peg to accept orders for the DSI cooker. Kovan at the time had expressed to Smith its willingness to manufacture and supply the DSI cookers on behalf of Gold Peg provided that Smith could obtain a re-assignment of rights in the DSI cooker.



Gold Peg began taking orders for the DSI cooker and forwarding them to Kovan for manufacture and supply. As part of the manufacturing process, Kovan developed further engineering drawings (*the RotaTherm drawings*) based on the Alfa-Laval drawings. In 1994, Gold Peg attempted to secure rights in the DSI cooker (including the copyright in the RotaTherm drawings) in a confidentiality agreement. Kovan did not sign the confidentiality agreement, instead choosing to implement a strategy of not responding to any of Gold Peg's attempts to secure such rights. In doing so, Kovan hoped to leverage Gold Peg's need to secure its rights with its own need to secure an exclusive manufacturing agreement.

The parties continued to deal with each other for approximately ten years with no substantial written terms until, in 2002, Gold Peg advised Kovan that it would be switching to a tendering system for the manufacture of the DSI cooker. In May 2002, Kovan submitted a quote, which included for the first time a charge for creating the RotaTherm drawings. Gold Peg objected to this claim to ownership of the RotaTherm drawings by Kovan, and on 5 July 2002, Gold Peg filed proceedings seeking an injunction under the Copyright Act 1968 (Cth), the *Trade Practices Act 1974* (Cth) and at general law.

## THE DECISION

Initially, Gold Peg applied for restraining orders to stop Kovan reproducing key drawings related to the DSI cooker by making, promoting, offering for sale, and/or selling machines utilising the DSI cooking system. The judge refused to restrain Kovan as there was not enough evidence to support the existence of an agreement between the parties with sufficient clarity or certainty to justify the restraining orders sought. Sundberg J ordered Gold Peg to pay Kovan's costs in relation to the application for restraining orders.

When the application for restraining orders failed, Gold Peg proceeded to trial and argued that there was an agreement between the parties made in or about 1992 (*the 1992 Agreement*), the terms of which were partly oral and partly implied. Gold Peg argued that it was a key term between the parties that Gold Peg would retain all rights in relation to the DSI cooker, including any copyright in the RotaTherm drawings. Gold Peg also argued that

Kovan had breached the *Trade Practices Act* and had passed off its own DSI cookers as those of Gold Peg.

Eight days into the trial, Gold Peg sought to amend its statement of claim so that it could use evidence of conversations between Smith and Kovan's directors to establish the existence of the 1992 Agreement. Kovan objected to the amendments, and further sought to amend its own defence and cross-claim. Kovan also lodged, on the same day, an application to disqualify the trial judge for apprehended bias. Gold Peg's amendments to its statement of claim were refused. Kovan's amendments to its defence and cross-claim were allowed, but the judge saw no reason to disqualify herself for apprehended bias.

The trial judge found in favour of Gold Peg on all its claims. Her Honour, Crennan J was especially swayed by Smith's constant insistence on his position as the exclusive owner rights in the DSI cooker (including the copyright in the Alfa-Laval drawings and RotaTherm drawings). Her Honour also found that, prior to the implementation of Kovan's policy to not acknowledge claims to ownership rights by Gold Peg or Smith, Kovan had accepted that Smith was the owner of rights in the DSI cooker. During a discussion with a former director of Kovan, Smith had asserted his ownership rights in the DSI cooker and the former director had responded by "shrugging" his shoulders. Her Honour emphasised that such a "shrug" constituted "body language" or "non-verbal communication" which may, in the relevant context, be capable of indicating acceptance of what was being said.

Kovan appealed the decision. The appeal was dismissed, with the Full Court of the Federal Court agreeing with the trial judge's findings. Kovan was ordered to pay costs of both the trial and the appeal.

## CONCLUSION

Ultimately, from Gold Peg's point of view, such legal proceedings could have been avoided had it secured the terms of its arrangement with Kovan in writing in 1992. Granted, Gold Peg had attempted to reach consensus with Kovan and tried to put terms to paper in 1994. However, Smith and Gold Peg then proceeded on the basis of Smith's constant verbal assertion of rights and Kovan's former director's "shrug" of acceptance. But by the time Gold Peg eventually insisted on written terms, Kovan sought to



use the lack of a written agreement dealing with the ownership of the rights in the RotaTherm drawings as leverage to secure an exclusive supply agreement.

From Kovan's perspective, avoiding written acknowledgment of Gold Peg's rights to the DSI cooker may have been a flexible strategy to maintain relations with Gold Peg. However, this ultimately cost Kovan the exclusive supply arrangement it sought to achieve. Also, by choosing to keep silent on the ownership of rights issue, Kovan was exposed to the court's interpretation of the former director's shoulder shrug. Once the Court accepted that act as an act of acceptance of Gold Peg's position, Kovan's claim to ownership was defeated and it was left having to pay significant court costs. Had Kovan chosen to deal with the issue at the time by negotiating and documenting an agreed position, it is possible that that agreed position may have been more favourable to Kovan than the outcome of the case.

The case also highlights the value of recording the key terms of an agreement in writing as a way of avoiding reliance on an individual's powers of recall. The evidence in the case included conversations of a few key people as recollected by them ten or more years later. Such evidence can be difficult to conclusively prove and in any event will ultimately come down to the credibility of witnesses, rather than interpretation of the written word.

In summary:

- (1) Get the key terms of an agreement in writing, especially if the relationship may be long-term or involve issues of rights ownership.
- (2) Get the key terms of an agreement in writing, wherever possible, before the relationship commences.
- (3) Watch not only what you say but also what you do in important commercial negotiations. Body language may be taken to be an act of acceptance or agreement of the other side's position.

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#### **FURTHER INFORMATION**

For further information or advice on the topics covered in this article or other intellectual property law matters please contact:

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