IN THE AUSTRALIAN ARBITRATION CENTRE No. MKM22 of 2022

BETWEEN

Fitzroy Distilling Company Pty Ltd (ACN 132 465 798) Claimant

- and -

Advanced Plant Manufacturing Pty Ltd (ACN 243 254 288) Respondent

JOINT REFERRAL TO ARBITRATION

1 By written agreement dated 28 March 2020, Fitzroy Distilling Company Pty Ltd (**FDC**) and Advanced Plant Manufacturing Pty Ltd (**APM**) contracted for APM to manufacture and supply to FDC certain equipment in exchange for payment (the **Agreement**).

2 By clause 21 of the Agreement, the parties agreed:

2.1 to refer any dispute arising from or in connection with the Agreement to expert determination; and

2.2 that, if either party was dissatisfied with the expert determination, it would have the right to apply to an arbitral tribunal to be dealt with *de novo*.

3 A dispute in relation to the Agreement was referred to an expert for determination in accordance with clause 21 of the Agreement. A copy of the expert's determination dated 5 May 2022 is at Annexure A (the **Determination**).

4 Both parties to the Agreement are dissatisfied with the conclusions reached in the Determination and hereby refer the dispute to arbitration by the Tribunal as now constituted.

5 The Determination correctly recites the facts and the parties' respective claims. The parties agree that they are not bound by the arguments put to the expert prior to making the Determination.

6 Neither party seeks to adduce any further evidence.

7 Neither party relies on any State or Commonwealth legislation.

8 No procedural issue arises in respect of the Determination and both parties accept the Tribunal's jurisdiction to hear and determine the dispute.

9 The issues are:

9.1 Did the Agreement contain an implied term that the bottles would not disintegrate when mixed with hand sanitiser?

9.2 Was the Claimant entitled to terminate the Agreement?

9.3 Is the Claimant required to pay APM $5,000 under clause 6.3 of the Agreement?

9.4 If the Claimant was entitled to terminate the Agreement, to what measure of damages is it entitled?

Fitzroy Distilling Company Pty Ltd
Claimant

Advanced Plant Manufacturing Pty Ltd
Respondent

ANNEXURE A

EXPERT DETERMINATION

5 MAY 2022

IN RESPECT OF THE DISPUTE ARISING BETWEEN

Fitzroy Distilling Company Pty Ltd

and

Advanced Plant Manufacturing Pty Ltd

Prof. the Hon. Rose Turner AM

FACTS

1 In early-2020, the COVID-19 virus emerged in Australia. At that time, the Commonwealth, State and Territory governments began issuing public health guidelines in order to reduce the spread of the virus. On advice from public health experts, the Health Ministers of the Commonwealth, the States and the Territories advised the public to wear a face-covering when out of the home and to adopt high hygiene standards. Those ministers recommended the use of hand sanitiser as an effective way of reducing the spread of COVID-19.

2 By February 2020, retail and wholesale vendors of hand sanitiser products had sold out. Wholesalers had not received imported hand sanitiser since January 2020, when the pandemic was emerging overseas. The domestic production of hand sanitiser met only a fraction of the demand.

3 In response, the Victorian Government determined in late-February 2020 to establish a scheme to secure a supply of locally-produced hand sanitiser (the **Scheme**). The Scheme was intended to encourage Victorian alcoholic beverage producers to produce hand sanitiser that was safe to use and effective. The Scheme was announced on 1 March 2020. The Scheme was advertised on social media, television and in print media. The Victorian Health Minister referred to the Scheme during every daily briefing to the public between 1 March and 17 March 2020.

4 Details of the Scheme were published on the Government's dedicated COVID-19 webpage. The details of the Scheme were as follows:

4.1 any producer of alcoholic beverages operating in Victoria and holding a licence issued by the Victorian Gambling and Casino Control Commission to produce alcohol in Victoria (a **Licensed Entity**) could submit a proposal on or before 17 March 2020 to participate in the Scheme;

4.2 the Government would pay any Licensed Entity to supply the Government with hand sanitiser for an amount of $4 per litre of hand sanitiser if the following conditions were met:

(a) the Licensed Entity must produce and deliver, to a designated Victorian Government storage centre, 100,000 litres of hand sanitiser within 3 calendar months of the date of its approval for the Scheme;

(b) the Licensed Entity must bottle the hand sanitiser in recyclable plastic bottles of not less than 150mL in volume;

(c) the Licensed Entity must produce hand sanitiser that:

(i) is not flammable;

(ii) does not expire within 3 years of the date of production; and

(iii) is composed of not less than 80% alcohol,

(collectively, the **Conditions**); and

4.3 the Government would only pay a Licensed Entity and take possession of the hand sanitiser the subject of its proposal if the Conditions were met.

5 The Government stated that the approval process under the Scheme would take 7 days from the date of application by Licensed Entity to participate in the Scheme.

6 Fitzroy Distilling Company Pty Ltd (**FDC**) is a Licensed Entity that, prior to March 2020, exclusively produced and bottled whiskey at a facility in Fitzroy North, Melbourne. At

that facility, FDC used a McConnell-Schumer brand bottling plant, which was capable of bottling a maximum of 20,000 litres of whiskey per month. FDC purchased the bottling plant from Advanced Plant Manufacturing Pty Ltd (**APM**) in 2009.

7 During February 2022, FDC had developed a recipe for a whiskey-based hand sanitiser for use by its staff and for the staff to take home to their families. The staff at FDC gave the whiskey-based hand sanitiser the nickname "Old Smokey", after its peaty aroma. If successful, FDC stood to make more money selling Old Smokey to the Government under the Scheme than by selling boutique whiskey to bottle shops and bars.

8 On 2 March 2020, the founder and sole director of FDC, Harriet Swanson, called the Sales Manager of APM, John Adams, to discuss whether APM could modify FDC's McConnell-Schumer plant, or supply and install an additional bottling plant that could meet the volume production requirements of the Scheme.

9 During that conversation, the Ms Swanson and Mr Adams discussed the following matters:

9.1 FDC proposed to apply for the Scheme;

9.2 FDC needed to increase its bottling capacity to reach at least 50,000 litres per month;

9.3 FDC needed to start bottling with a new or modified bottling plant by 1 April 2020 in order to meet the volume requirement of the Scheme; and

9.4 FDC needed the bottling plant to be able to fill plastic bottles of not less than 150mL with hand sanitiser constituted by at least 80% alcohol.

10 Mr Adams told Ms Swanson that APM could supply a "Manchin Plant Extender", which is a type of modular bottling plant equipment that is interoperable with existing bottling plants and is designed to increase the productive capacity of existing bottling plants (the **MPE**). The MPE was comprised of:

10.1 a plastic blow mould, which heats plastic pellets and uses air to form the bottles into which liquid is injected;

10.2 a parallel bottle in-feed conveyer rack, which takes the formed bottles and transfers them to the liquid-injection components of the existing plant;

10.3 a parallel bottle out-feed conveyer rack and capping press, which:

(a) takes the filled bottles from the existing liquid injection components and, while in motion, applies a plastic cap to the filled bottle and affixes it using heat; and

(b) releases the filled and capped bottles onto a conveyor belt for labelling and packing.

11 Mr Adams told Ms Swanson that the MPE could be supplied, installed and operational within five business days of entering a sale and purchase agreement. After the telephone call, Mr Adams sent a PDF copy of a document prepared by the manufacturers of the MPE to Ms Swanson that explained how the MPE operated and also how it integrated with existing bottling plants. By reply email, Ms Swanson said "Thanks John – this looks like it will be perfect for hand-sanitiser. Here is a PDF copy of the Scheme pamphlet, as discussed." Ms Swanson's email attached a copy of a Department of Health summary document that set out the background and objectives of the Scheme, and the Conditions.

12 Mr Adams responded by email saying "Yes, it looks like you'll be onto a winner with Old Smokey."

13 On 3 March 2020, Ms Swanson decided to apply for the Scheme and to enter into an agreement with APM to supply and install the MPE. In the afternoon of 3 March 2020, FDC and APM entered into an agreement to that effect (the **Agreement**). The Agreement provided as follows:

13.1 APM would supply and install the MPE at FDC's premises (clause 3.1);

13.2 the supply and installation under clause 3.1 would occur no later than 5 business days after the date of the Agreement (clause 3.2);

13.3 APM warranted to FDC that the MPE would:

(a) add no less than 40,000 litres of bottling capacity per month to a "USA – Category B Bottling Plant", of which FDC's McConnell-Schumer bottling plant was defined in clause 1.1 to be an example (clause 5.3);

(b) produce plastic bottles (using polyethylene terephthalate (**PET**)) of a capacity of 150mL (clause 5.4);

13.4 FDC would pay:

(a) $85,000 on delivery and installation of the MPE (clause 6.1);

(b) $45,000 on the date falling 3 months after the date of delivery and installation (clause 6.2); and

(c) $5,000, in the event that payment under clause 6.1 or clause 6.2 is not made within 2 business days of the prescribed date for payment (clause 6.3);

13.5 APM would supply FDC with PET pellets to produce bottles in the MPE blow mould in sufficient volume to make bottles with an aggregate volume of 200,000 litres.

14 After FDC and APM executed the Agreement, on 3 March 2020, Ms Swanson completed an online application form for the Scheme on the Government's COVID-19 website. When completing the form, Ms Swanson provided documentary evidence of FDC's status as a Licensed Entity and information concerning its capacity to meet the Conditions.

15 At 9.12am on 4 March 2020, Ms Swanson received an email from an officer of the Department of Health advising her that FDC's application to participate in the Scheme had been approved (the **Department Email**). The Department Email advised that if FDC could provide hand sanitiser in accordance with the Conditions, FDC would receive payment not less than 30 days after delivery of the hand sanitiser. The Department Email notified Ms Swanson that, in order to be eligible for the Scheme, FDC was required to deliver its hand sanitiser on or before 4 June 2020.

16 The Department Email also stated that, if FDC met the Conditions, it would be on a shortlist of prospective of suppliers of hand sanitiser from which the Government would select an exclusive supplier of hand sanitiser to Parliament House in Melbourne. The Department Email stated that this would be for a volume of hand sanitiser not less than 10,000 litres per year, for three years, at the same price in the Scheme.

17 On the morning of 8 March 2020, in accordance with the Agreement, APM installed the MPE at FDC's premises. After testing it, Mr Adams and two technicians employed by APM told Ms Swanson that they were satisfied that FDC's McConnell-Schumer plant

and the MPE were fully integrated and operational. FDC paid the $85,000 required under the Agreement that day.

18 From the evening of 8 March 2020, FDC began bottling Old Smokey using its improved bottling plant and the PET supplied by APM to produce the bottles. The McConnell-Schumer plant, in conjunction with the MPE, included a machine process that applied labels to the bottles of Old Smokey. Once labelled, the bottles of Old Smokey were distributed via a conveyor belt to a large bench area for packing into cartons.

19 Ms Swanson found the modified bottling plant to work almost faultlessly. It produced labelled bottles of Old Smokey faster than APM had indicated that it would.

20 Between 8 March 2020 and 3 June 2020, FDC produced and bottled 110,000 litres of Old Smokey. The cost of producing that volume of Old Smokey, excluding the cost of the MPE under the Agreement, was:

20.1 $32,000, for the ingredients of Old Smokey;

20.2 $2,500, for parts and other repairs undertaken on the new bottling plant; and

20.3 $45,000, for the fees for three contractors engaged for three months to pack the Old Smokey bottles into crates for shipping,

totalling $89,500 (together, the **Production Costs**).

21 On 4 June 2020, a national logistics company hired by FDC delivered the cardboard crates containing FDC's Old Smokey to a Richmond warehouse designated under the Scheme. The delivery contained 110,000 litres of Smokey.

22 Upon delivery, an officer of the Department of Health emailed to Ms Swanson a record of receipt of the hand sanitiser, which included the following statement:

> *Responsible Officers of the Department of Health will assess your hand sanitiser for compliance with the Scheme Conditions.*
>
> *If your hand sanitiser complies with the Scheme Conditions, payment will be made promptly.*
>
> *If your hand sanitiser does not comply with the Scheme Conditions, you must collect it within 2 Business Days or it will be sent to landfill.*

23 On 7 June 2020, an officer of the Department of Health sent an email to Ms Swanson, which included the following:

> *A Responsible Officer appointed under the Scheme has assessed the hand sanitiser delivered to the Richmond Designated Location by you.*
>
> *The Responsible Officer has determined that your hand sanitiser does not comply with the Scheme Conditions because:*
>
> *(1) the bottles containing the hand sanitiser are only 135mL in volume; and*
>
> *(2) the hand sanitiser produces blisters and a painful rash when applied to the hands.*
>
> *Our safety testing laboratory have determined that the plastic material used to make the bottles, when mixed with the hand sanitiser, breaks down and releases a chemical into the hand sanitiser which is harmful to the skin.*
>
> *Your hand sanitiser otherwise complied with the Scheme Conditions.*
>
> *Given your delivery does not comply with the Scheme Conditions, you will not be considered for the exclusive supply agreement for Parliament House.*

> *Please arrange for collection of your hand sanitiser before close of business on 9 June 2020, or your hand sanitiser will be sent to landfill.*

24 Ms Swanson decided to leave the bottles Old Smokey at the Richmond warehouse. All of the Old Smokey was disposed of in landfill on 10 June 2020.

CLAIM

<u>Claim 1: Bottle volume</u>

25 FDC claims that APM breached clause 5.4 of the Agreement because the bottles produced using the MPE were only 135mL in volume, entitling FDC to terminate for breach.

26 In response, APM contends that the requirement in clause 5.4 is not an essential term of the contract giving rise to a right to terminate.

<u>Claim 2: Implied term</u>

27 FDC claims that it was an implied term of the Agreement that the plastic supplied to produce the bottles of Old Smokey would not disintegrate when storing Old Smokey, a hand sanitiser comprised of 80% alcohol. FDC claims that APM breached this implied term because the bottles were found to have disintegrated when inspected by the Responsible Officers, and were determined to be unsafe for use because the PET had disintegrated into the Old Smokey.

28 In response, APM rejects that the Agreement contained the implied term contended for by FDC. APM admits, however, that if the term was implied, the term was breached.

<u>Claim 3: Quantum of damages</u>

29 FDC claims that it is entitled to:

29.1 $85,000 in respect of the purchase price paid for the MPE (**Purchase Price Damages**);

29.2 further or alternatively, $440,000 minus the Production Costs, being $350,500, for the loss of profit FDC would have made under the Scheme (**Loss of Profit Damages**);

29.3 or, alternatively to paragraph 29.2 above, $89,500 in respect of the Production Costs (**Reliance Damages**); and

29.4 further or alternatively, $120,000 in respect of lost profit FDC could have made under the exclusive agreement to supply hand sanitiser to Parliament House (**Loss of Chance Damages**).

30 In response, APM contends that on the assumption FDC was entitled to terminate the Agreement for breach, FDC:

30.1 is not entitled to Loss of Profit Damages;

30.2 is not entitled to Reliance Damages; and

30.3 is not entitled to Loss of Chance Damages.

COUNTERCLAIM

31 APM claims that FDC owes $50,000, being comprised of:

31.1 the $45,000 balance of the purchase price for the MPE, due on 8 June 2020; and

31.2 $5,000, being the amount stipulated in clause 6.3 of the Agreement.

32 In response, FDC contends that:

32.1 by reason of APM's breaches of the Agreement, no amount is owing to APM; and

32.2 further and alternatively, clause 6.3 is an unenforceable penalty.

CONSIDERATION

Claim 1

33 APM has breached the promise in clause 5.4 of the Agreement that the MPE would produce bottles with a capacity of 150mL. The MPE produced bottles with a 135mL capacity.

34 However, I do not consider that clause 5.4 was an essential term of the contract. Further, I do not consider that APM's breach in this respect constituted a serious breach of an intermediate term.

35 Therefore, FDC's claim under Claim 1 is rejected.

Claim 2

36 FDC contends that the Agreement included an implied term to the effect that the bottles, when in contact with the hand sanitiser, would not disintegrate and alter the chemical composition of the hand sanitiser.

37 I am persuaded, having regard to the circumstances referred to above, that the term for which FDC contends passes the *BP Refinery*[1] test for implying contractual terms.

38 As such, I find that the Agreement contained the implied term as framed by FDC. APM concedes that if the Agreement contained such a term, APM breached that term.

Claim 3

39 FDC contends that it is entitled to various heads of damages. In my view, only two heads of damages are available to FDC; the Purchase Price Damages and Loss of Profit Damages.

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[1] *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 180 CLR 266 at 283.

40 The Purchase Price Damages reflect the difference between what FDC paid to APM and the value of the MPE to FDC. FDC has no other use for the MPE, which is purpose-built to produce plastic bottles for sale in the Scheme. FDC otherwise produces whiskey in glass bottles.

41 The Loss of Profit Damages are consequential losses of FDC which fall within the second limb of *Hadley v Baxendale*[2].

42 Given my conclusion as to the Loss of Profit Damages, to award the Reliance Damages would amount to double recovery. Therefore, the Reliance Damages are not awarded.

43 I have considered the evidence adduced by FDC in connection with its claim for Loss of Chance Damages. That evidence showed that the Department of Health told only two other Licensed Entities that they would be considered for the hand sanitiser supply contract with Parliament House. On the basis of the evidence and the submissions to me, I consider that there was an equal chance between each of FDC and the other two Licensed Entities of being awarded the exclusive contract.

44 However, the Loss of Chance Damages are not available because a promisee cannot recover losses in respect of a lost opportunity. Therefore, the Loss of Chance Damages are not awarded.

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[2] (1854) 9 Ex 341; 156 ER 145.

COUNTERCLAIM

45 The obligation of FDC to pay the $45,000 balance of the purchase price under clause 6.2 was contingent upon APM's compliance with the Agreement. Given my conclusion in respect of APM's breach of the implied term, APM's counterclaim in this respect must fail.

46 The obligation in clause 6.3 to pay $5,000 appears to be an independent obligation on the part of FDC to pay APM in respect of late payment. I do not consider this to be an unenforceable penalty. FDC should pay this amount.

CONCLUSION

47 In view of my findings, I determine that FDC is entitled to recover from APM an amount equal to:

47.1 the Purchase Price Damages, being $85,000; plus

47.2 the Loss of Profit Damages, being $350,500; minus

47.3 the amount required to be paid by FDC to APM in clause 6.3, being $5,000.

48 Accordingly, I determined that APM should pay to FDC an amount of $430,500 in satisfaction of FDC's claims under the Agreement.

Prof. the Hon. Rose Turner AM
Ellesmere Chambers