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Termination for Convenience or not?

William Dixon*

Termination for convenience clauses continue to be commonly encountered in commercial contracts. To delineate between circumstances where these clauses may be safely relied upon to terminate contracts and circumstances where the invocation of these clauses may be successfully resisted involves a nuanced challenge for commercial parties and their advisors. This article examines the complex matrix of factors likely to impinge on this determination.

Introduction

The intended operation of a termination for convenience clause, permitting the beneficiary of the clause to terminate a contract at any time[1] with impunity,[2] is well understood. In practice, what poses a far greater challenge is to determine the impediments to successful reliance upon a termination for convenience clause. Before looking at the origin and practical operation of these clauses, the scope of this article must first be clarified.

From 12 November 2016 the statutory unfair contract terms regime[3] was extended to apply to clauses in standard form contracts[4] formed in the small business arena.[5] Under this legislation, a termination for convenience clause that is only exercisable by one party to the contract may well constitute an unfair contractual term.[6] However, this article examines the origin and practical operation of termination for convenience clauses that are to be found in the considerable number of commercial contracts[7] such as contracts for major construction works or long term projects[8] that operate outside the present reach of the unfair contract terms regime or other regulatory regimes.[9]

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[1] Subject to any contractually specified notice period.

[2] That is, without being liable to pay damages.

[3] Part 2-3 (Unfair Contract Terms) of the *Australian Consumer Law* as contained in Schedule 2 of the *Competition and Consumer Act 2010* (Cth).

[4] In determining if a contract is standard form contract a court may take into account such matters as it thinks fit but must take into account those matters listed in s 27(2) of the *Australian Consumer Law*.

[5] Being contracts for the supply of goods or services, or a sale or grant of an interest in land, entered into with small businesses having fewer than 20 employees and having an upfront contract price of $300,000 or less or $1,000,000 or less if the term of the contract is more than 12 months: s 23(4) of the *Australian Consumer Law*.

[6] Section 25 of the *Australian Consumer Law* provides examples of the kinds of contractual terms that may be unfair. Specifically, s 25(b) provides that a contractual term that permits one party (but not the other party) to terminate the contract may be unfair.

[7] Termination for convenience clauses as may appear in certain employment contracts are outside the scope of this article.

[8] Examples noted by Ruth Loveranes 'Termination for Convenience Clauses' (2012) 14 *University of Notre Dame Australia Law Review* 103, 104

[9] For example, the *Franchising Code of Conduct* now contains an overarching obligation that parties act in good faith in their dealings with one another. As noted in the Competition and Consumer (Industry Codes—Franchising) Regulation 2014 Explanatory Statement: 'The most significant change from the 1998 Code is the introduction of an obligation on the parties to a franchise agreement to act

Origin - Executive necessity

It has been noted elsewhere that the origin of the termination for convenience clause is to be found in government contracts and the common law doctrine of 'executive necessity' that permits governments to unilaterally terminate a contract with impunity where the termination is for policy or budgetary reasons.[10] This doctrine, which arose from and was initially confined in application to the need to address the exigencies of wartime,[11] has been accepted as a general doctrine and broadly applied by the High Court of Australia.[12] Seddon describes the termination for convenience clause as the 'contractualisation' of the doctrine of executive necessity and notes that such a clause has both benefits and drawbacks for the other contracting party.[13] The benefit is that there may be a provision for compensation in the event of termination[14] but the downside is that the right to terminate can be invoked, at least on a literal interpretation, 'for convenience'.[15]

In light of this historical background it may seem to follow that governments should be able to rely on termination for convenience clauses in a relatively unfettered way. However, the small amount of case law dealing with disputes involving government contracts suggests otherwise. In the same way that governments are expected to be model litigants, as noted by Finn J in *Hughes Aircraft Systems International v Airservices Australia*,[16] governments ought to be model contractors who are seen to exercise their contractual rights fairly.[17] More specifically, in relation to good faith and termination for convenience clauses,[18] it seems that if governments are not held to an elevated standard of conduct they will, at the very least, be held to the same standard as private contractors.[19] Furthermore, regardless of any legal limitations on the doctrine of executive necessity, whether expressed by way of a termination for convenience clause or not, the

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in good faith (clause 6). This obligation applies both to franchisors and franchisees in respect of any matter arising under or in relation to the franchise agreement or the Franchising Code. The meaning of good faith under the Franchising Code is the same as at common law. While the obligation is not defined the Franchising Code contains a non-exhaustive list of matters that the courts may have regard to when determining whether a breach of the obligation has occurred. The purpose of this list is also to provide some guidance to assist franchise participants to understand the nature of their obligation to act in good faith.'

Also, Standards Australia has released a draft of its proposed new standard general conditions of contract, DR AS 11000:2015 (a standard used widely in construction contracts). One of the proposed changes is the introduction of an express obligation of good faith on the parties, specifically to 'act reasonably in a spirit of mutual trust and cooperation, and generally in good faith towards the other'. See: http://www.standards.org.au/OurOrganisation/News/Documents/Standards%20Australia%20-%20Proposed%20Revisions%20to%20Australian%20Standard%20on%20General%20Conditions%20of%20Contract.pdf

[10] S A Christensen, W D Duncan *The Construction and Performance of Commercial Contracts* (Federation Press, 2014) 105; Loveranes, n 8, 103-104; Nick Seddon 'State Instrumentalities and Sovereign Risk' (2005) *Australian Mining and Petroleum Law Association Yearbook* 29.

[11] *Rederiaktiebolaget Amphitrite v The King* [1921] 3 KB 500, 503 but note that the High Court applied the doctrine earlier in *Watson's Bay & South Shore Ferry Co Ltd v Whitfeld* (1919) 27 CLR 268.

[12] *Ansett Transport Industries (Operations) Pty Ltd v Commonwealth* (1977) 139 CLR 54.

[13] Nick Seddon 'State Instrumentalities and Sovereign Risk' (2005) *Australian Mining and Petroleum Law Association Yearbook* 29, 33.

[14] This is separately considered later in this article under the heading 'Illusory consideration?'.

[15] Seddon, n 13, 33.

[16] (1997) 76 FCR 151.

[17] *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151, 196.

[18] Separately explored in greater detail later in this article.

[19] *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200.

requirement of governments to answer to the voters at elections, as well as the scrutiny of agency ratings,[20] will necessarily prevent governments from relying too readily on this power.[21] In a sense, the requirement to exercise the power under the termination for convenience clause properly may be seen to be inherent where governments are concerned.

However, no such scrutiny applies to private entities. Thus the question of how, if at all, the operation of a termination for convenience clause should be limited where it arises in the commercial contracting arena falls for consideration.

An implied obligation of good faith?

In decisions to date, an issue that has arisen on a number of occasions is whether the exercise of a power to terminate a contract pursuant to an express termination for convenience clause, is subject to an implied obligation of good faith.[22] Whether there is, or ought to be, an obligation incumbent upon commercial contracting parties to deal with each other in good faith is a question which has not yet been answered by the High Court. Apart from noting that the good faith issue was not raised in argument in *Commonwealth Bank of Australia v Barker*[23] ('*Barker*'), a relatively recent decision that dealt with the possible implication of terms of mutual trust and confidence in an employment context, the last time that the High Court had the opportunity to consider the implication of good faith was in the 2002 case of *Royal Botanic Gardens and Domain Trust v South Sydney City Council*[24] where the opportunity was not taken up.

Implication of good faith – a matter of fact or law?

Apart from the difficulty of knowing if an implication of good faith will be made per se, there is the difficulty of knowing if the implication is to be made as a matter of fact or law. At a more general level, the High Court observed in *Barker* that courts in the past have implied terms both as a matter of fact, and as a matter of law, but did not comment as to which basis of implication, if any, was to be preferred.[25] Nevertheless, the Court held that where an implication is made, it should only be made as a matter of absolute necessity[26] (i.e. applying a test of 'reasonableness' is not enough)[27] and should not overstep the limits of judicial power. It is perhaps of some relevance that the High Court, whilst clearly acknowledging its law-making function, also

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[20] Which will look unfavourably upon a polity that appears to take its contractual obligations lightly.
[21] Seddon, n 13, 29.
[22] It has been noted, extra-judicially, that the use of a termination for convenience clause is often characterized as an act not done in good faith: Chief Justice Marilyn Warren 'Good Faith: Where are we at?' (2010) 34 *Melbourne University Law Review* 344, 356.
[23] [2014] HCA 32.
[24] [2002] HCA 5.
[25] *Commonwealth Bank of Australia v Barker* [2014] HCA 32, [19]-[22].
[26] *Commonwealth Bank of Australia v Barker* [2014] HCA 32, [28]-[29], [36]-[37], [60]-[62] [114].
[27] *Commonwealth Bank of Australia v Barker* [2014] HCA 32, [29].

noted that Australia's common law must 'evolve within the limits of judicial power and not trespass into the province of legislative action.'[28]

In the absence of any direction from the High Court on the wider issue of good faith in the performance of contracts,[29] it is fair to say that Australian state courts have grappled with the question of whether an implication of good faith (should such an implication be made) is to be made as a matter of fact or law and have arrived at somewhat inconsistent conclusions depending on the state jurisdiction involved. The seeds for the current jurisprudential uncertainty were sown some time ago as the following brief overview of a number of the better known authorities will demonstrate.

The acknowledged starting point was *Renard Constructions (ME) Pty Ltd v Minister for Public Works*[30] ('*Renard*'), where a majority of the New South Wales Court of Appeal held that there was an implied duty for the principal to act reasonably in exercising a right to terminate, but was uncertain as to the basis upon which the obligation was implied. As noted by the author elsewhere,[31] this case was an unfortunate starting point in a doctrinal sense in that the decision engendered uncertainty.

Arguably the historical high water mark for the implication of good faith was reached by the New South Wales Court of Appeal in 2001 in *Burger King Corporation v Hungry Jack's Pty Ltd*[32] ('*Burger King'*), where it was suggested that such an obligation of good faith should be implied generally into all commercial contracts. Perhaps unfortunately, in terms of precedent, although the implication in *Burger King* was said to be made as a matter of law, the language of implication in fact was used in that the court considered whether the term should be implied into the particular contract before it, rather than making an implication in a defined class of contract.

Between the starting point in *Renard* and the high water mark in *Burger King*, the observation is aptly made that confusion abounded.[33] To confirm the veracity of this observation, the results in the following representative sample of decisions from that time are illustrative of the differing approaches that were on display. In *Hughes Aircraft Systems International v Airservices Australia*,[34] Finn J favoured implication both

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[28] *Commonwealth Bank of Australia v Barker* [2014] HCA 32, [19].

[29] In *Commonwealth Bank of Australia v Barker* [2014] HCA 32, French CJ, Bell and Keane JJ (at [42]) left open the question 'whether there is a general obligation of good faith in the performance of contracts'. The plurality noted (at [42]) that their conclusion also did not 'reflect upon the related question whether contractual powers and discretions may be limited by good faith and rationality requirements analogous to those applicable in the sphere of public law' as these questions were not before the Court. In a separate judgment, Kiefel J noted (at [107]) that good faith had not been raised in argument and that is was 'therefore neither necessary nor appropriate to discuss good faith further, particularly having regard to the wider importance of the topic.'

[30] (1992) 26 NSWLR 234.

[31] Bill Dixon 'Good Faith in Contractual Performance and Enforcement: Australian Doctrinal Hurdles' (2011) 39(4) *Australian Business Law Review* 227, 235.

[32] (2001) 69 NSWLR 558.

[33] Christensen and Duncan, n 10, 64-67.

[34] (1997) 146 ALR 1.

in fact and law. Implication as a matter of fact alone was made in *Advance Fitness v Bondi Diggers*[35] and *Dalcon Constructions Pty Ltd v State Housing Commission.*[36] By way of a further variation, in *Saxby Bridge Mortgages Pty Ltd v Saxby Bridge Pty Ltd*[37] Simos J rejected the implication of a term of good faith on the basis that the requirements for implication ad hoc were not satisfied. Simos J did not consider the possibility of implication as a matter of law.

Since *Burger King* there has been far greater judicial reluctance to accept that an implication of good faith should be made as a matter of law in all commercial contracts.[38] However, once again, the approach is inconsistent and varied across the different state jurisdictions.[39] While there is broader acceptance that 'commercial contracts' is too wide and indeterminate a class of contract to form the basis of implication at law,[40] there continue to be decisions from both New South Wales[41] and South Australia[42] where the courts have been prepared to imply a good faith obligation by way of law into certain commercial and other contracts.

Chief Justice Marilyn Warren of the Supreme Court of Victoria, writing extra-judicially, has downplayed the importance of the in fact/at law distinction by suggesting that all of the three mechanisms available to courts to deal with good faith, that is, implication by law,[43] implication in fact, or purposive interpretation (construction),[44] require the court to consider the commercial purpose of the contract. Warren CJ suggests that as 'commercial purpose' include notions of 'business efficacy', 'obviousness' and policy considerations the end point would ultimately be the same.[45]

Notwithstanding these observations of Warren CJ, starting with the 2005 decision of the Victorian Court of Appeal in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL*,[46] the Victorian courts in recent times have clearly evinced a judicial approach where implication as a matter of law has been eschewed in

[35] [1999] NSWSC 264.
[36] (1998) 14 BCLC 477.
[37] [2000] NSWSC 433.
[38] Christensen and Duncan, n 10, 65.
[39] Christensen and Duncan, n 10, 65.
[40] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [NSWCA] 15; see also *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228.
[41] See, e.g., *Adventure World Travel Pty Ltd v Newsom* [2014] NSWCA 174 (where the implied term of good faith arose in the context of an employment contract).
[42] See, e.g., *Alstom Ltd v Yokogawa Australia Pty Ltd* [2012] SASC 49.
[43] In *Commonwealth Bank of Australia v Barker* [2014] HCA 32, French CJ, Bell and Keane JJ in referring (at [24]) to the issue of whether terms implied in law are rules of construction noted that this involved taxonomical distinctions which did not necessarily yield practical differences.
[44] Good faith imputation from a process of construction has received some limited judicial approval but was heavily disparaged by Giles JA in *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15.
[45] Warren, n 22, 348.
[46] [2005] VSCA 228.

favour of implication as a matter of fact (if at all).[47] By way of example, in *Specialist Diagnostic Services Pty Ltd (formerly Symbion Pathology Pty Ltd) v Healthscope Ltd*[48] the Victorian Court of Appeal opined[49] that in the case of a contract between commercial entities of equivalent bargaining power, a good faith obligation will ordinarily arise only if meeting the tests for implication as a matter of fact laid down in *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council*.[50]

It has been noted previously by the author[51] and by others[52] that the possibility of a good faith obligation being implied as a matter of fact is not without its own 'doctrinal hurdles'. In particular in the realm of commercial contracting between parties of roughly equal bargaining power this approach in Victoria has meant that it has been often difficult to convince a court that the strict requirements for implication as a matter of fact have been satisfied.[53] Part of this difficulty arises from the earlier observations by the Victorian Court of Appeal in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL*[54] that a good faith obligation may be confined to an 'unbalanced'[55] contractual relationship where an obligation of good faith may be needed to protect a vulnerable party from exploitative conduct.[56] As such, Warren CJ opined that the obligation would not find application in contracts between 'two commercial leviathans'.[57]

The Victorian preference for implication of a good faith obligation to be made (if at all) as a matter of fact, rather than law, is also manifested in Tasmania where the Full Supreme Court has opined that good faith is dependent upon the principles of ad hoc implication.[58] In terms of the remaining state jurisdictions, it is accurate to say that the position in West Australia[59] and Queensland[60] remains unclear.[61]

In relation to both the basis for implication and wider issues surrounding a good faith obligation, there is no doubt that the position in Australia is unsettled and this appears to be because of residual unease about implying a duty of good faith and how that impinges upon freedom of contract and the notion that

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[47] See, e.g., *Specialist Diagnostic Services Pty Ltd (formerly Symbion Pathology Pty Ltd) v Healthscope Ltd* [2012] VSCA 175; *Androvitsaneas v Members First Broker Network Pty Ltd* [2013] VSCA 212; *Vakras v Cripps* [2015] VSCA 193 as well as numerous decisions at first instance.
[48] [2012] VSCA 175.
[49] *Specialist Diagnostic Services Pty Ltd (formerly Symbion Pathology Pty Ltd) v Healthscope Ltd* [2012] VSCA 175, [87].
[50] (1977) 180 CLR 266.
[51] Dixon, n 31, 227.
[52] Christensen and Duncan, n 10, 65.
[53] See, e.g., *DPN Solutions Pty Ltd v Trident Pty Ltd* [2014] VSC 511.
[54] [2005] VSCA 228.
[55] *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [4].
[56] *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [4] and [25].
[57] *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [4].
[58] *Tote Tasmania Pty Ltd v Garrott* (2008) 17 Tas R 320.
[59] Edelman J in *Sino Iron Pty Ltd v Mineralogy Pty Ltd [No 2]* [2014] WASC 444 noted (at [239]) that implication of a term of good faith remained a 'vexed issue'.
[60] The Queensland judiciary, whilst recognising the division in existing authorities concerning the basis for implication, have largely found it unnecessary to decide the issue. See, e.g., *Lockhart v Holden* [2008] QSC 257, [62].
[61] CCH *Australian Contract Law Reporter* [28-640].

contractual obligations are voluntarily assumed.[62] As will be demonstrated below, the unsettled state of the law generally is also reflected in litigation in relation to termination for convenience clauses. Rather than grapple with some of the wider issues involved, the approach has been rather more piecemeal with the courts generally preferring the approach of interpreting the words of the particular contract[63] and, in particular, any fetters upon the operation of the termination for convenience clause.[64]

Decisions considering termination for convenience clauses and good faith

Before looking at decisions considering termination for convenience clauses per se, it is instructive to first mention the relevance of two key decision that have already been mentioned considering good faith and termination rights more generally. The first decision, *Renard*,[65] involved a construction contract where a contractual right to terminate was granted subject to requiring the defaulting party being able to 'show cause' as to why the contract should not be terminated. The contractor was called upon to show cause, but despite doing so, the principal terminated the contract. The majority of the New South Wales Court of Appeal held that there was an implied duty for the principal to act reasonably in exercising its right to terminate.

The second decision is *Burger King*.[66] Although dealing with termination rights more generally, rather than termination for convenience, there are two judicial observations by the New South Wales Court of Appeal of direct relevance to the present discussion. First, was the curial observation that termination rights should not be used to achieve a foreign purpose[67] and, secondly, the observation that good faith obligations would more readily find application in standard form contracts that included a general power of termination.[68] By way of dicta, Finn J also subsequently opined that a requirement of good faith would apply to the exercise of a power to terminate a contract for convenience.[69] Against this background, it is appropriate now to consider decisions dealing with termination for convenience clauses per se.

Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd[70] involved a dispute about a contractual right to terminate (or to reduce the scope of the contract) for convenience by notifying the contractor in writing.[71] The apparent reason for the clause was to allow Australian Aerospace to terminate in the instance that the

[62] Loveranes, n 8, 112.
[63] This approach is particularly apparent in Victorian decisions dealing more generally with good faith claims. For example, in *Androvitsaneas v Members First Broker Network Pty Ltd* [2013] VSCA 212 the Victorian Court of Appeal noted (at [108]) that 'whether a power conferred upon a party to a contract is fettered by a duty of good faith depends upon the terms in which the power is expressed.'
[64] Jennifer McVeigh and Kimie Tsukakoshi 'Termination for Convenience – Not as Easy as it Sounds' (2013) 29 *BCL* 122.
[65] (1992) 26 NSWLR 234.
[66] (2001) 69 NSWLR 558.
[67] *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, 573-574.
[68] *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, 569.
[69] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1, [753].
[70] [2007] VSC 200.
[71] The termination for convenience clause in question was based on government procurement standard terms: Loveranes, n 8, 105.

Commonwealth terminated the head contract.[72] On the issue of whether good faith should limit the operation of this clause the Victorian Supreme Court considered that there was a serious question to be tried and granted an interlocutory injunction to that end.[73] It should be noted that Kellogg Brown & Root Pty Ltd had invoked a dispute resolution process after having received the notice from Australian Aerospace Ltd terminating the contract for convenience. The court considered that Australian Aerospace, by not permitting the dispute resolution process to proceed, had pre-empted what may have been a favourable result for Kellogg Brown & Root Pty Ltd. To this extent, the interlocutory decision reached by the court seems to have been influenced, in part, by the right of the contractor to raise a notice of dispute in relation to the principal's notice of termination for convenience.

A similar dispute arose in *Sundararajah v Teachers Federation Health Ltd*.[74] At first instance, Davies J granted an interlocutory injunction on the basis that there was a serious question to be tried as to whether Teachers Federation Fund's contractual right to end an agreement on the giving of 90 days' notice was limited by a good faith obligation. His Honour said that where there is a broad and unqualified power to terminate, there is room to imply contractual limitations or to impose equitable constraints on that power.[75] However, on appeal to the Federal Court, Foster J did not share this view, instead opining that where a power is given to one party to be exercised in its sole discretion so as to bind the other, the terms of the contract will necessarily be inconsistent with a constraint on the exercise of that power by considerations of reasonableness or good faith.

In *Solution 1 Pty Ltd v Optus Networks Pty Ltd*,[76] Hammerschlag J said that an obligation of good faith could be excluded where Optus had an 'absolute discretion' to terminate its marketing and sale arrangement with Solution 1 upon the giving of 120 days' notice. His Honour reasoned such an implication should not be made on the basis that it would be inconsistent with the express terms of the contract. Notably, the agreement also expressly excluded all terms that would otherwise be implied into the agreement.

Similarly, in *Starlink International Group Pty Ltd v Coles Supermarkets Australia Pty Ltd*[77] a contract allowed Coles to terminate its agreement with a trolley collection service at 'any time without reason' upon the giving of 45 days written notice. After being made aware of allegations about Starlink's conduct, Coles terminated the agreement. No reasons for the decision were provided by Coles. For Starlink it was argued that an implied obligation of good faith meant that Coles should have advised Starlink of the allegations and provided

[72] Refer to back to back arrangement as discussed subsequently in this article.
[73] The dispute was subsequently settled out of court.
[74] [2009] NSWSC 1443.
[75] This approach of Davies J was subsequently noted with approval by Cowdroy J in *N A Retail Solutions Pty Ltd v St George Bank Ltd* (2010) 267 ALR 599, [41].
[76] [2010] NSWSC 1060.
[77] [2011] NSWSC 1154.

Starlink with the opportunity to address them before invoking the termination power. Bergin CJ was unwilling to imply an obligation of good faith holding that to do so would be inconsistent with the express terms of the clause. It was opined to be axiomatic, when invoking a termination for convenience clause, 'parties will act for some reason and sometimes for a reason that may not present to others as a good reason.'[78]

In *Trans Petroleum (Australia) Pty Ltd v White Gum Petroleum Pty Ltd*[79] the licensor of a particular system used to operate a convenience store and service station sought to terminate a fuel re-selling agreement in accordance with its contractual right to terminate for convenience. On behalf of Trans Petroleum (Australia) Pty Ltd it was argued that the termination by White Gum Petroleum Pty Ltd was to avoid a daily fee cap of 12% of gross sales and that as a result the power to terminate had not been exercised in good faith. The Western Australian Court of Appeal firmly rejected the implication of an obligation of good faith in this case because it was considered inconsistent with a general unfettered right to terminate for convenience.

Most recently, *Caratti Holdings v Coventry Group*[80] involved a dispute concerning a lease that contained a clause giving the tenant absolute discretion to require the landlord to carry out development of certain building works. In this case Martin J of the Supreme Court of WA, referring to *Barker*, rejected the notion that good faith (implied at law or in fact) could restrict the operation of a very broadly drafted clause, but noted that the High Court had yet to resolve this issue.

As can be seen from this brief overview of relevant authorities, there is clearly scope and some judicial support for an argument that a termination for convenience clause may be subject to a good faith obligation. Although those making this argument have enjoyed less success in recent decisions this is largely due to the drafting of the clause in issue and/or express exclusion of the putative implied term. Both these issues are the subject of separate consideration subsequently in this article.

This review of the relevant case law leaves a further argument unresolved. As already mentioned, a general view that has found particular favour in Victoria is that an obligation of good faith may only be needed to protect a vulnerable party from exploitative conduct. An issue that may arise in the future is to what extent an information imbalance as between commercial contracting parties may form the basis for a claim of 'vulnerability'. Interestingly, there is at least some academic support for the view that good faith should be implied where there is an information imbalance between the parties in the context of the potential exercise

[78] *Starlink International Group Pty Ltd v Coles Supermarkets Australia Pty Ltd* [2011] NSWSC 1154, [32].
[79] (2012) 268 FLR 433.
[80] [2014] WASC 403.

of a termination for convenience clause. Anthony Gray has suggested that a contractual party whose contract is liable to be terminated by the operation of a termination for convenience clause cannot know in advance the likelihood of the clause being exercised and therefore cannot weigh the risks associated with the contract not proceeding.[81] Due to this information imbalance, Gray suggests that the way in which the principal uses a termination for convenience clause should be fettered by an implication of good faith.[82]

If applicable, what does 'good faith' mean in this context?

Should a good faith obligation prove to be a fetter on the exercise of a termination for convenience clause, the next question, and potential difficulty, is what the actual content of a duty of good faith is and how this might operate practically to limit a termination for convenience clause. In this context, an extrajudicial statement of Sir Anthony Mason[83] has garnered universal respect and is regularly the subject of judicial citation both in relation to implied obligations of good faith[84] as well as express obligations.[85] Mason referred to three concepts underpinning good faith being:

(a) an obligation on the parties to co-operate in achieving the contractual objects;

(b) compliance with honest standards of conduct; and

(c) compliance with standards of conduct which are reasonable having regard to the interests of the parties.[86]

While courts have had a somewhat inconsistent approach to identifying and naming good faith per se, they have readily related good faith to concepts of reasonableness, lack of capriciousness or arbitrariness and not exercising rights for an extraneous purpose.[87] Given the relative paucity of case law that deals with good faith in relation to a termination for convenience clause, it is unsettled as to how these requirements might limit such a clause. Anthony Gray has previously considered this question and proposed how a requirement of good faith might apply should a termination for convenience clause be exercised in certain scenarios.[88] There are three (3) scenarios considered by Gray.[89]

The first scenario involves *back to back arrangements*. This is where a head-contractor includes a termination for convenience clause in their agreement with sub-contractors to mirror the fact that the client/principal has included a termination for convenience in their agreement with the head contractor. Gray suggests that

[81] Anthony Gray 'Termination for Convenience Clauses and Good Faith' (2012) 7(3) *Journal of International Commercial Law and Technology* 260, 267.
[82] Gray, n 81, 267.
[83] Sir Anthony Mason 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66.
[84] See, e.g., *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268, [146].
[85] See, e.g., *North East Solution Pty Ltd v. Masters Home Improvement Australia Pty Ltd* [2016] VSC 1, [8].
[86] Mason, n 83, 69.
[87] *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Sundararajah v Teachers Federation Health Ltd* [2009] NSWSC 1443.
[88] Gray, n 81, 272.
[89] Informed by the author's discussion with industry.

if a client/principal terminates with a head-contractor, the head-contractor would generally be acting in good faith if they then terminated their agreement with the sub-contractor.[90] When relied on for this reason, the head-contractor will have acted honestly and reasonably and not capriciously or improperly or for a reason other than for what the clause was intended.[91]

The second scenario involves unforeseen circumstances. Gray suggests that where a party's financial position has changed for reasons beyond its control, such as a global financial crisis, then assuming there is evidence that the changed financial position is genuinely caused by the event,[92] termination in those circumstances would be honest, reasonable and not arbitrary or capricious; in other words, in good faith.

The third scenario involves a preference for another contract. Gray argues that where a party has found an alternative supplier or contractor able to perform the same work at the same standard for a cheaper price then termination of the original contract to take advantage of the windfall gain represented by the 'better deal' is not in good faith[93] as it would be 'contrary to the spirit of the underlying bargain between the original contracting parties.'[94] The potential abuse of a termination for convenience clause in this manner has also been noted by others.[95]

The impact of drafting of the individual termination for convenience clause

It is apparent from the case law reviewed that any impact that an implication of good faith will have on a termination for convenience will be significantly dependent upon the terms of the individual clause and also whether any good faith obligation is sought to be excluded either expressly or impliedly.[96] Before separately considering the issue of express exclusion, it is appropriate to first consider the impact of the individual drafting of the termination for convenience clause. In this regard, it is possible to identify three broad categories of termination for convenience based on the actual words used in the drafting of the clause.[97]

[90] Assuming that no action of the head-contractor caused the principal to exercise the termination for convenience clause and the sub-contractor received appropriate compensation: Gray, n 81, 273.
[91] To adopt the language of Hargrave J (at [89]) in *DPN Solutions Pty Ltd v Tridant Pty Ltd* [2014] VSC 511 there could be no suggestion of this being 'anything other than a rational commercial decision.'
[92] Gray, n 81, 273.
[93] Gray makes the interesting point that those in industry who he had spoken with generally considered that this was not a valid exercise of a termination for convenience clause: Gray, n 81, 275 (footnote 94).
[94] Gray, n 81, 274.
[95] See, example, Loveranes, n 8, 110.
[96] These issues have been previously considered elsewhere in greater detail by the author: Bill Dixon, 'Can the Common Law Obligation of Good Faith be Contractually Excluded?' (2007) 35 *Australian Business Law Review* 110.
[97] These three categories are broadly consistent with observations made by Loveranes, n 8, 103.

In the first category, the termination for convenience clause is clear, unambiguous and without qualification. For example, the clause under consideration in *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*[98] provided for termination to occur by the principal 'at its option, at any time and for any reason it may deem advisable.' This clause was considered by Justice Templeman[99] to provide an absolute and unfettered discretion such that good faith was not implied. Similarly, the clause in *Starlink International Group Pty Ltd v Coles Supermarkets Australia Pty Ltd*[100] provided for termination 'at any time without a reason' by giving 45 days written notice. The clear wording of this clause was also not considered to be subject to any obligation of good faith. As previously mentioned, the decisions reached in *Trans Petroleum (Australia) Pty Ltd v White Gum Petroleum Pty Ltd*[101] and *Caratti Holdings v Coventry Group*[102] are also representative of broadly drafted clauses providing unfettered rights to terminate for convenience.

As part of this discussion, separate mention needs to be made of an agreement giving a principal 'sole discretion' in relation to the exercise of the termination for convenience clause. Although there is persuasive case authority that good faith will not be implied in these circumstances,[103] it should not be assumed that this result will flow in all instances. For example, one of the submissions made in *Burger King* was that the clauses of the agreement established objective benchmarks against which the grant or withholding of operational, financial and legal approval was to be made making it unnecessary to imply an obligation of good faith. In rejecting this submission, the court opined as follows concerning the granting of these approvals being within the 'sole discretion' of Burger King:

> If full force is given to that concept ['sole discretion'], it would allow BKC to give or withhold relevant approval "at its whim" including capriciously, or with the sole intent of engineering a default of the Development Agreement, giving rise to a right to terminate.[104]

The drafting implications of this decision are clear. Suggestions that a good faith obligation has been excluded by the presence of a 'sole discretion' clause, by itself, will not necessarily find judicial favour.[105]

In the second category, the termination for convenience clause may be described as bare. For example, the clause simply provides that a principal 'can terminate for convenience' or 'can terminate by written notice.' Drafting of this type is more likely to open up the possibility of an implication of good faith. A similar result

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[98] *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 130.
[99] Justice Templeman's decision on the entitlement of the principal to terminate the contract was upheld on appeal.
[100] [2011] NSWSC 1154.
[101] (2012) 268 FLR 433.
[102] [2014] WASC 403.
[103] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 (although not involving a termination for convenience, the case is persuasive as the distribution agreement in question gave Vodafone a sole discretion to determine sales levels for a distributor).
[104] *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, [176].
[105] Dixon, n 96, 118.

may flow in the third category where the clause is qualified or relies upon some contingency. For example, where the clause states that the principal 'may terminate by giving notice in writing' there is obiter that good faith would be implied.[106] Also where there is a provision for dispute resolution such as in *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd*,[107] and there is a dispute resolution process already taking place, as previously noted, there was held to be at least a serious question regarding good faith.[108]

Express exclusion of the good faith obligation

Even if an implied obligation of good faith may otherwise constitute a potential fetter on the exercise of a termination for convenience clause, the issue of express exclusion of the implied obligation must always be considered.[109] There is no doubt that a clearly and carefully worded express exclusion clause in a commercial contract can operate to exclude any implied obligation of good faith as an express contractual term will always overcome an implied term where there is inconsistency.[110] This result will flow regardless of whether the obligation of good faith is implied as a matter of fact[111] or law.[112]

The express exclusion may be of all implied terms as in *Solution 1 Pty Ltd v Optus Networks Pty Ltd*[113] or good faith specifically. Alternatively, the contract may expressly provide a deeming provision such that any exercise of the right of termination is deemed to be exercised in good faith.[114]

What remains less clear is the effect of an 'entire agreement' clause. While there are judicial declarations that an entire agreement clause will exclude an implied obligation of good faith,[115] this issue is far from clear cut[116] and may be dependent on whether good faith is implied as a matter of fact or law.[117] As noted by Finn J in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*,[118] an entire agreement clause, by

[106] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1, 174.
[107] [2007] VSC 200.
[108] *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200, [7].
[109] It is expressly acknowledged that the discussion of express exclusion of a good faith obligation is consistent with a more detailed analysis undertaken by the author elsewhere: Dixon, n 96.
[110] *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886, [75].
[111] *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 283.
[112] See, example, *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, [173]; *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288, [64].
[113] [2010] NSWSC 1060.
[114] Consistent with the suggestion made in O'Byrne SK, 'Good Faith in Contractual Performance: Recent Developments' (1995) 74 *Canadian Bar Review* 70, 96.
[115] See, example, Mansfield J in *NT Power Generation Pty Ltd v Power and Water Authority* (2001) 184 ALR 481, 571.
[116] For example, in *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 Byrne J was prepared to assume that a good faith obligation was not excluded by an 'entire agreement' clause.
[117] Dixon, n 96, 119.
[118] (2003) 128 FCR 1.

itself,[119] should not be enough to exclude a duty of good faith.[120] For reasons that have been developed more fully by the author elsewhere,[121] it is suggested that the view of Finn J should be preferred.

If it is intended, on behalf of the beneficiary of the termination for convenience clause, to exclude any obligation of good faith that may be implied, it is suggested that exclusion of the good faith obligation should be expressed as clearly as possible. In order for an 'opting out' clause to be effective, it would be prudent to say words to the effect 'that the implied obligation of good faith does not apply to the extent that the implied obligation may limit the rights otherwise lawfully available under the terms of the contract or at law.'[122] The reference in this formulation to 'lawfully available' is intended to make it clear that the 'opting out' clause is not intended to condone dishonesty.[123]

Where a commercial document expressly and unambiguously excludes any implied obligation of good faith, naturally 'it will then be a matter for a party's commercial judgment if the party is prepared to sign the document in that form.'[124]

What is the relevance of a compensation regime?

A separate question that arises is whether the inclusion in a contract of a compensation regime means that any obligation of good faith has either been satisfied or would not be implied as a potential fetter on the exercise of the termination for convenience (regardless of the reason for the termination). The Australian Government Solicitor ('AGS') notes that if the Commonwealth exercises its rights under a termination for convenience clause it will be typically liable for costs incurred by the contractor directly attributable to the termination.[125] This is not unique to government contracts as Wedutanko notes.[126] Indeed, any terminated contractor will be entitled to recover costs for work undertaken up to the date of termination to the extent that these represent unconditionally accrued rights,[127] including payment for any milestones that have been met.

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[119] A different result will flow where an 'entire agreement' clause is coupled with an express exclusion of all implied terms as in *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15, [200].
[120] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1, 174.
[121] Dixon, n 96.
[122] Dixon, n 96, 120.
[123] A clause that allowed one party to the contract to be dishonest would be rendered vulnerable on public policy grounds: O'Byrne, n 114, 96.
[124] Dixon, n 96, 121.
[125] 'Termination for Convenience' Commercial Notes, Number 27, Australian Government Solicitor, 3 June 2008 <http://www.ags.gov.au/publications/commercial-notes/comnote27.htm>.
[126] 'Giving government some flexibility: making your termination for convenience clause work' Alexandra Wedutenko (Lexology) Australia October 30 2014 <http://www.lexology.com/library/detail.aspx?g=58a301cb-c0a6-4fb4-9f94-8ed6d14c46a7>.
[127] *McDonald v Denny Lascelles Ltd* (1933) 48 CLR 457.

In addition to these rights of payment, it is suggested that adequate compensation in the event of a termination for convenience ought to have been determined at the negotiation phase.[128] The types of compensation resulting from the termination that might be recoverable could include redundancies, lease cancellation payments, materials/equipment payout and subcontractor termination costs.[129]

A recent example of a formula used to compensate for termination for convenience can been seen in the case of *McMahon v Cobar*.[130] The contractual formula was as follows:

22.7 Principal liability - termination for convenience or Principal's breach

If this Contract is terminated in accordance with clause 22.1 or clause 22.5, the Principal will only be liable for:

(a) the payment for the Contractor's Activities properly carried out to the date of termination;

(b) extra costs necessarily and reasonably incurred by the Contractor as a result of termination subject to the Principal's rights of set off at the rates specified in schedule 3; and

(c) a percentage of the value of the Contractor's Activities that are no longer required to be performed by the Contractor from the date of termination, calculated in accordance with the formulae below, representing the Contractor's loss of profits:

(i) Agreed Maximum Project Cost as at the date of termination - (the amount calculated in accordance with clause 22.7(a) + the amount calculated in accordance with clause 22.7(b)) x 0.15; plus

(ii) any share of savings calculated in accordance with the following formula:

*(**A-B**) x 50%*

Where:

***A** is the proportion of the Agreed Maximum Project Cost that would have been payable based on the rates and lump sums set out in the schedules (subject to adjustment in accordance with the Contract) at the date the termination is effective, before taking into account the items at clauses 22.7(b) and (c) above; and*

***B** is the Approved Actual Costs at the date the termination is effective, before taking into account the items at clauses 22.7(b) and (c) above.*

Notwithstanding the contractual formulation in this instance, the principal tried to circumvent the compensation that formed part of the termination for convenience clause by alleging a breach by the contractor. In fact the contractor was not in breach and the principal's wrongful allegation was repudiatory. The case is a good example of the need to comply with any express limitations in a termination for

[128] Of course, despite the risk involved for a contractor, it may be difficult to negotiate adequate compensation: Bruce D Page, 'When Reliance is Detrimental: Economic, Moral, and Policy Arguments for Expectation Damages in Contracts Terminated for the Convenience of the Government; (2008) 61 *Air Force Law Review* 1, 16-17 as referred to by Loveranes, n 8, 104 (footnote 8).
[129] Wedutenko, n 126.
[130] [2014] NSWSC 502.

convenience clause, such as notice requirements. Failure to do so could be considered repudiation of the contract, which entitles the other party to recover damages, the measure of which will likely exceed the compensation the contractor would otherwise be entitled to if the termination right been validly exercised.[131]

As for government contracts, the inclusion of a contractual requirement in a private enterprise commercial contract to pay compensation for the consequences of a termination for convenience may mitigate against any finding of a good faith fetter on the exercise of a power. In this regard, the decision of McDougall J in *Leighton v Arogen*[132] is instructive. Justice McDougall granted an order that required Arogen, the contractor, to vacate a site upholding the termination of a contract for convenience. Justice McDougall opined:

> It is very hard to see how an entitlement to terminate "for convenience", accompanied by the obligation to pay what the parties must be taken to have agreed would be fair compensation for the consequences of such termination, could be conditioned by any obligation of good faith. On the contrary, I would have thought, such a right was one to be exercised according to idiosyncratic or personal notions of convenience, and not necessarily one constrained by any concept of good faith.[133]

This judicial observation raises the question of the consequence of compensation not being provided for. While bargain damages (or damages for loss of profits) would not usually be included,[134] if a termination fee or compensation is not provided for, then the contract may, according to some commentators, be illusory.

Illusory consideration?

It has been argued that a strict interpretation of a termination for convenience clause could render a contract void and unenforceable on the basis that the party with a totally unfettered termination for convenience clause available to them may terminate at any time, thus making the performance of the promise optional and the contract unsupported by valid consideration.[135] This is a significant point because clauses that are potentially void will not be viewed favourably by the court in keeping with the long-standing doctrine that courts should adopt a construction of contractual terms which preserves the validity of the promise.[136] Christensen and Duncan suggest that allegations of an illusory contract or promise in the context of termination for convenience may prompt courts to adopt a construction that places a good faith limitation on the exercise of the right to terminate for convenience so as to avoid any question of the contract being void and unenforceable.[137] The use of a good faith limitation in this manner has been accepted in a number of decisions from the United States.[138]

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[131] Wedutenko, n 126.
[132] [2012] NSWSC 1370.
[133] *Leighton v Arogen* [2012] NSWSC 1370, [22].
[134] As this would defeat the intended purpose of the termination for convenience clause.
[135] Assuming that the contract is not in the form of a deed for which consideration is not required or in the form of a statutory agreement.
[136] See, for example, *Meehan v Jones* (1982) CLR 571, 589.
[137] Christensen and Duncan, n 10, 109.
[138] As discussed by Loveranes, n 8, 110-112.

In this regard, it may be seen as significant that the AGS has previously argued that the inclusion of a requirement to pay compensation mitigates against the risk of there being no enforceable promise. This is because the effect of such compensation is that rather than allowing the principal the option whether to perform the contract, the principal may choose how it will perform the contract;[139] either by paying the compensation or by performance.[140] However, the question has been posed whether payment for work performed up to the point of termination will always constitute good consideration.[141] Loveranes notes a seminal authority from the United States[142] where because the termination for convenience clause in question enabled a principal to terminate the contract before any work had been done at all, they had effectively promised nothing and payment of this nature was not considered as providing consideration.[143]

Loveranes does note that where a discrete termination fee has been negotiated over and above a payment for services rendered, regardless of how small the termination fee, proper consideration will have been provided and the doubt surrounding the illusory nature of the consideration will have been removed.[144] In this regard, reference is made[145] to the decision of Graham J in *Anderson Formrite Pty Ltd v Baulderstone Pty Ltd (No 7)*.[146] In this case, the requirement for the principal to pay a termination fee of $1,[147] where the contract was terminated for convenience, was held to be critical in providing consideration to sustain the valid formation of the contract.[148] It is respectfully suggested that this result is congruent with the AGS position outlined above.

Conclusion

This article has demonstrated that parties and their advisers will need to pay close regard to a raft of factors, a number of which remain unresolved, in order to form a view as to whether the invocation of a termination for convenience clause in a commercial contract may be successfully challenged. The particular jurisdiction involved; the factual circumstances in which the clause is invoked including the underlying reasons supporting a principal's exercise of the right; the individual drafting of not only the clause itself but also any attempts to exclude good faith obligations as well as any compensation or termination fee that may be

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[139] This choice has been referred to as the 'Alternative Performance' argument: Loveranes, n 8, 107.
[140] AGS, n 125.
[141] Loveranes, n 8, 107.
[142] *Torncello v US* 681 F 2d 756 (1982).
[143] Loveranes, n 8, 108.
[144] Loveranes, n 8, 108.
[145] Loveranes, n 8, 108.
[146] [2010] FCA 921.
[147] The failure by the respondent to make this payment of $1 constituted a breach of contract entitling the applicant to succeed with its breach of contract claim.
[148] *Anderson Formrite Pty Ltd v Baulderstone Pty Ltd (No 7)* [2010] FCA 921, [237].

payable in exchange for the termination may all impact on the advice to be given. Unfortunately, there can be no such thing as standard advice when confronted with this complex matrix.