

# 'TERMINATION FOR CONVENIENCE' CLAUSES

RUTH LOVERANES\*

## Abstract

A 'termination for convenience' clause allows one party to a contract to terminate the contract without cause. Although these clauses are increasingly being used to provide flexibility in contracts, they have been given little judicial consideration. This article seeks to examine a number of concerns and difficulties which these clauses raise, including the limit which good faith may place upon the broad termination power of these clauses.

## I INTRODUCTION

Contracts for long term projects must provide a great deal of flexibility to contracting parties who may need to respond to any unforeseen difficulties in performing the contract. Contracting parties are increasingly using 'termination for convenience' clauses ('TC clauses') to provide that flexibility. A TC clause grants one party ('the principal') the power to terminate a contract at its discretion, regardless of whether the other party ('the contractor') is in breach. There are, however, a number of concerns and difficulties which these clauses raise, which will be examined in this article.

The TC clause will be explained initially to provide the background and a better understanding of such clauses, followed by a discussion, firstly, of concerns involving illusory consideration and enforceability, secondly, of the role that the notion of good faith plays or should play to limit the broad termination power of such clauses, and finally some theoretical concerns.

## II TC CLAUSE EXPLAINED

A TC clause allows the principal to terminate a contract at its option, regardless of whether the contractor is in default. The origin of TC clauses can be traced to government contracts and the common law doctrine of 'executive necessity'.<sup>1</sup> This doctrine allows the government

---

\* LLB(Hons), University of Notre Dame Australia.

1 See generally Nicholas Seddon, *Government Contracts: Federal, State and Local* (Federation Press, 4th ed, 2009) 233-244. For a brief history of TC clauses in the United States, see Joseph J Petrillo and William E Connor, 'From Torncello to Krygoski: 25 Years of the Government's Termination for Convenience Power' (1997) 7 *Federal Circuit Bar Journal* 337.

to break a contract, without paying damages, where breaking the contract is necessary in order to address changing public interests.<sup>2</sup> For example, the government may rely on this doctrine where it breaks a contract due to the necessities of war.<sup>3</sup> The inclusion of an express TC clause in a government procurement contract therefore reflects the government's need for flexibility in its contractual relationships.

TC clauses can, however, also be inserted into contracts between private parties as well. These clauses are now increasingly being used in both government and private contracts for major construction works and other long term projects.<sup>4</sup> Since contracting for large projects involves a scheme of contracts, a TC clause in a head contract would be expected to be mirrored in subcontracts, to ensure that each contract down the line may be terminated if the head contract is terminated.<sup>5</sup>

Although it is not unusual for contracts to include a clause granting one of the parties a unilateral right to terminate, for example, as can be commonly found in employment contracts,<sup>6</sup> these contracts are usually set within a framework of statutory rights and obligations. In the case of employment contracts, the prevailing framework of statutory rights and obligations would protect an employee from wrongful termination or unfair dismissal.<sup>7</sup> However, in many contracts subject to TC clauses there is often no such protection extended to the contractors involved.

The exercise of a TC power can potentially cause great damage to a contractor. A contractor may rely on a contract by relinquishing any opportunities for other work and by directing all of its resources to the performance of the contract. Though a contractor might attempt to increase the price of the contract to account for the risk of termination for convenience,<sup>8</sup> it is often difficult to calculate and plan for such a risk.

---

2 Seddon, above n 1, 234.

3 *Rederiaktiebolaget 'Amphitrite' v The King* [1921] 3 KB 500; *Commissioner of Crown Lands v Page* [1960] 2 QB 274.

4 John Tackaberry, *Termination for Convenience* (April 2002) Society of Construction Law, 1 <<http://www.scl.org.uk/node/541>> ; J W Carter, 'Partial Termination of Contracts' (2008) 24 *Journal of Contract Law* 1, 13. See, for example, *Tbiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 130.

5 See, for example, *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200 (15 June 2007).

6 See for example *New South Wales Cancer Council v Sarfarty* (1992) 28 NSWLR 68.

7 See *Fair Work Act 2009* (Cth) ss 385-392.

8 See 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.

There are not many Australian cases involving TC clauses. *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd*<sup>9</sup> ('*Kellogg Brown*') is one example of a case which involved a standard TC clause, based on government procurement standard terms.<sup>10</sup> The relevant portion of the TC clause in this case is set out below:

- 12.3.1 In addition to any other rights it has under the Contract, AA may terminate the Contract or reduce the scope of the Contract by notifying the Contractor in writing.
- 12.3.2 ...
- 12.3.3 AA shall only be liable for:
  - a. payments under the payment provisions of the Contract for work conducted before the effective date of termination;
  - b. any reasonable costs incurred by the Contractor that are directly attributable to the termination;
  - c. ...
 where the Contractor substantiates these amounts as determined by the AA Contract Manager.
- 12.3.4 The Contractor shall not be entitled to profit anticipated on any part of the Contract terminated.
- 12.3.5 The Contractor, in each Approved Subcontract, shall secure the right of termination and provisions for compensation functionally equivalent to that of AA under clause 12.3.

It can therefore be said that a TC clause has three main features:

- 1) There is no express restriction on the principal's discretion to terminate the contract;
- 2) The principal is liable to pay compensation for any work performed up until the point of termination; and
- 3) The contractor is not entitled to claim lost profits for the balance of the contract.

In Commonwealth procurement contracts, a clause similar to paragraph b above (hereafter referred to simply as 'paragraph b') is usually included in the TC clause. This means that the principal is also liable to compensate for costs incurred that are directly attributable to the early termination, for example, the costs of preparing the termination settlement. TC clauses in private sector contracts do not, however, usually contain a clause similar to paragraph b; these private sector contracts would therefore operate differently to Commonwealth contracts.

Where a TC clause applies, the promises exchanged by the parties could arguably be said to be undermined because the principal can terminate

---

9 [2007] VSC 200 (15 June 2007).

10 Defence Materiel Organisation, *ASDEFCON (Strategic Materiel): Part 2 - Draft Conditions of Contract* (October 2009) Department of Defence, [12.3.5] <[http://www.defence.gov.au/dmo/gc/asdefcon/docs/V2\\_3\\_PT2\\_Draft\\_COC.pdf](http://www.defence.gov.au/dmo/gc/asdefcon/docs/V2_3_PT2_Draft_COC.pdf)>.

the contract at will. Arguably the TC clause removes any obligation on the principal to perform the contract and pass any benefit to the contractor. The clause therefore risks rendering the contract void. This argument would, of course, be less compelling if a provision similar to paragraph b was included in the TC clause (in other words, if there was an obligation for the principal to pay the contractor costs attributable to early termination). This will again be taken up in the discussion below.

### III ILLUSORY CONSIDERATION AND ENFORCEABILITY CONCERNS

One of the concerns raised about TC clauses is that contracts containing such clauses are void because such a broad termination power renders the consideration for that contract illusory.

#### A *Illusory Consideration*

Illusory consideration is obviously no consideration and does not give rise to a contractual obligation. This was illustrated in *Placer Development Ltd v Commonwealth*.<sup>11</sup> In this case, the plaintiff made an arrangement with the Commonwealth to form a company that would import and export timber. The Commonwealth agreed to pay a subsidy 'of an amount or at a rate to be determined by the Commonwealth from time to time'.<sup>12</sup> Since this clause gave scope for the Commonwealth to refuse to pay the subsidy at all, the majority of the High Court held that the clause did not amount to a contractual obligation.<sup>13</sup> Kitto J explained as follows:

[W]herever words which by themselves constitute a promise are accompanied by words showing that the promisor is to have a discretion or option as to whether he will carry out that which purports to be the promise, the result is that there is no contract on which an action can be brought at all.<sup>14</sup>

In the subsequent case of *MacRobertson Miller Airline Services v Commissioner of Taxation (WA)*,<sup>15</sup> Barwick CJ held that an airline ticket did not give rise to a binding contract because it contained a sweeping exemption clause that gave the airline the right to cancel bookings at any time and refuse to carry passengers.<sup>16</sup>

---

11 (1969) 21 CLR 353.

12 Ibid 354.

13 Ibid 357 (Kitto J): 'The Commonwealth's promise is, in substance, a promise to pay such subsidy if any as may be decided upon from time to time... It therefore does not create any contractual obligation.' See also ibid 361 (Taylor and Owen JJ): '[T]he clause amounts to no more than a promise to pay what, in all the circumstances, the Commonwealth in its discretion thinks fit and, as such, is wholly unenforceable.'

14 Ibid 356 (Kitto J).

15 (1975) 133 CLR 125.

16 Ibid 133 (Barwick J): 'The exemption of the ticket in this case fully occupies the

The principle drawn from these cases, that a promise will not give rise to a binding agreement if it reserves an unfettered discretion as to whether to perform it, can be applied to contracts containing a TC clause. Puri argues that such a clause allows a party to revoke a contract at will and renders the performance of the agreement optional.<sup>17</sup> Following this line of reasoning, the consideration (the promise to perform) that apparently supports the agreement is illusory and meaningless and the agreement itself is therefore void.<sup>18</sup> However, as will be seen below, there are divided opinions on whether consideration is in fact given by any compensation provision for exercising the early termination rights given by a TC clause.

### B *The 'Alternative Performance' Argument*

Some commentators have argued that TC clauses do not render a contract void because the principal has an obligation to compensate for the work done up until termination.<sup>19</sup> While the contract is on foot, there are obligations on both parties which provide consideration. A TC clause that provides for payment for services rendered should therefore be distinguished from a situation where the contract does not stipulate for any compensation at all.<sup>20</sup> The Australian Government Solicitor, in its *Commercial Notes*,<sup>21</sup> observed that, rather than render performance optional, the TC clause 'permits the Commonwealth to decide how it will perform the agreement (either by seeing the agreement through to the end or by paying the contractor compensation).'<sup>22</sup>

---

whole area of possible obligation, leaving no room for the existence of a contract of carriage.' Barwick CJ did, however, suggest that the terms of the ticket would apply in the event the airline did choose to carry passengers: *ibid* 133.

17 KK Puri, *Australian Government Contracts: Law and Practice* (CCH Australia, 1978) 180-184. Puri states at 181: 'The legal power created by this clause is not made conditional upon dissatisfaction with the results; it is a power to cancel if the government so wills or desires. Government's option between cancelling and not cancelling is unlimited. Obviously therefore a promise by the government which does not bind it... renders the government's promise illusory and lacks mutuality.'

18 *Ibid*.

19 Nicholas Seddon, *Government Contracts: Federal, State and Local* (Federation Press, 2nd ed, 1999) 240; Carter, above n 4, 23; Deborah Browitt, Paul Lang and John Scala, 'Termination for Convenience' (2008) 27 *Commercial Notes* 1.

20 See Seddon, above n 19, 241; Carter, above n 4, 23; *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130, 151 (McHugh J); *Abbey Developments v PP Brickwork Ltd* [2003] EWHC 1987 (TCC) (4 July 2003)[54] where Lloyd J recognised that T/C clauses that do not provide for compensation risk being treated as 'leonine and unenforceable as unconscionable.'

21 Browitt, Lang and Scala, above n 19, 1.

22 *Ibid* 2.

However, in *Torncello v United States* ('*Torncello*'),<sup>23</sup> a seminal United States case on TC clauses, Bennett J offered a different view on the particular circumstances in the case. Bennett J's concern was that the TC clause in question allowed the principal to terminate the contract before the contractor had engaged in any work at all.<sup>24</sup> Since there was room for the principal to do this, the contract had no minimum term and the contractor was effectively promised nothing.<sup>25</sup> In this case, compensation for services rendered could not be treated as consideration supporting such an agreement.<sup>26</sup>

### C Termination Fee

One way to remove any doubt about illusory consideration is to ensure the contractor is guaranteed something over and above compensation for services rendered. In Commonwealth procurement contracts, the principal promises to pay 'any reasonable costs incurred by the Contractor that are directly attributable to the termination'.<sup>27</sup> Since compensation for anticipated profits on the balance of the contract is expressly excluded, it appears the provision for 'reasonable costs incurred' includes the costs associated with stopping performance, terminating and settling subcontracts, and preparing and settling the termination proposal. The principal's promise to compensate for the consequences of early termination ensures the contract is not rendered void by the TC clause.

A termination fee, no matter how small, will secure the enforceability of a contract containing a TC clause. In *Anderson Formrite Pty Ltd v Boulderstone Pty Ltd* (No 7),<sup>28</sup> Graham J examined a formwork contract containing a TC clause that required the principal to pay a fee of \$1 in the event of termination for convenience. Graham J noted that the TC clause would have rendered the contract unenforceable if the contract did not require the principal to pay the \$1 fee.<sup>29</sup> This small termination fee ensured the agreement was supported by consideration.<sup>30</sup>

---

23 681 F 2d 756 (Ct Cl, 1982).

24 Ibid 769-770.

25 Ibid.

26 Ibid 770. See footnote 10 on page 770 of the judgment. See also *Questar Builders Inc v CB Flooring LLC*, 978 A 2d 651, 670 (Md, 2009) (Maryland Court of Appeals).

27 See *Kellogg Brown* [2007] VSC 200 (15 June 2007) discussed above.

28 [2010] FCA 921 (25 August 2010).

29 Ibid [103]-[105], [237]

30 Ibid [237]: 'The respondent's promise to pay that amount [\$1] was critical to the formation of a contract between the parties for which there was consideration.'

## D *Contracts by Deed*

It is important to note that the requirement of consideration can be avoided altogether if the contract is executed by deed. It is well established that contracts by deed do not require consideration to be enforceable.<sup>31</sup> This is because the solemnity of making a promise in a deed under seal is said to overcome the necessity for consideration.<sup>32</sup>

## E *Statutory Agreements*

Illusory consideration is generally not an issue for statutory agreements. Statutory agreements are essentially government contracts that have been entrenched in or recognised by statute.<sup>33</sup> There are two broad categories of statutory agreements: agreements that have been given the force of law 'as if enacted', and agreements that have merely been approved and therefore given validity by statute.<sup>34</sup>

The effect of giving a contract legislative force 'as if enacted' is that it is elevated to legislative status and carries statutory rights and obligations.<sup>35</sup> Where a TC clause is included in such an agreement, the government's termination power is a statutory power which is given authority by parliament. It is suggested that, in this situation, any arguments concerning illusory consideration are irrelevant because the rules of contract do not apply.<sup>36</sup> On the other hand, the effect of giving a contract statutory approval is that it remains a contractual agreement.<sup>37</sup> However, the backing of parliament ensures that its validity cannot

---

31 The contract need only be signed by the party to be bound and attested by a witness who is not a party to the contract: see *Property Law Act 1969* (WA) s 9 and equivalent provisions in other States.

32 *Morley v Boothby* (1825) 3 Bing 107, 111-112.

33 John Nongorr, 'The Legal Effect and Consequences of Conferring Legislative Status on Contracts' (1992-1993) 17 *University of Queensland Law Journal* 169; Leigh Warnick, 'State Agreements' (1988) 62 *Australian Law Journal* 878.

34 See Warnick, above n 33 and Seddon, above n 19, 113 which identify four more specific categories.

35 *Commonwealth Aluminium Corp Ltd v Attorney General (Qld)* [1976] Qd R 231; *West Lakes Ltd v South Australia* (1980) 25 SASR 389; *Wik Peoples v Queensland* (1996) 187 CLR 1, 99 (Brennan CJ); *Sankey v Whitlam* (1978) 142 CLR 1, 89 (Mason J), 105-106 (Aicken J).

36 But see Nongorr, above n 33, 179: The rules of contract may not be completely irrelevant where the agreement is a valid contract at common law and it is possible for contractual rights and remedies to run side by side with statutory rights and remedies.

37 See for example *Mineralogy Pty Ltd v Western Australia* [2005] WASCA 69 (14 April 2005) [13].

be questioned.<sup>38</sup> Many commentators have recognised that statutory approval cures defects in a contract by effectively declaring it valid<sup>39</sup> so it seems that statutory approval could also ensure that a contract supported by illusory consideration will be enforceable.<sup>40</sup>

#### IV GOOD FAITH LIMITS AND ITS DIFFICULTIES

Although a TC clause may not render a contract void, there is concern that a principal may abuse its TC power and seriously undermine the promises made under the contract. A TC clause could, for example, be used by the principal to take work away from a contractor in order to have the work done at a cheaper price. An implied obligation of good faith may limit the use of a TC clause to prevent such a result. However, case law from the United States and Australia suggest that good faith is not a very stringent limit.

##### A *The Position in the United States*

Much of the case law on TC clauses comes from the United States ('US') since TC clauses have had a long history there.<sup>41</sup> An implied obligation of good faith is well established in the US.<sup>42</sup> Section 1-203 of the *Uniform Commercial Code*<sup>43</sup> states that 'every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement'. Section 205 of the *Restatement (Second) of Contracts*<sup>44</sup> also recognises an implied duty of good faith and fair dealing in all contracts. A number of US cases also point to good faith as a necessary limit on TC clauses, in order to prevent contractual promises from being rendered illusory.

In *Questar Builders Inc v CB Flooring LLC* ('*Questar*'),<sup>45</sup> Questar contracted with CB Flooring to install carpeting in a number of

---

38 *Sankey v Whittam* (1978) 142 CLR 1, 89 (Mason J), 105-106 (Aicken J); *Ansett Transport Industries (Operations) Pty Ltd v Commonwealth* (1977) 139 CLR 54; *Wik Peoples v Queensland* (1996) 187 CLR 1, 258-259 (Kirby J); *Re Michael; Ex parte WMC Resources* [2003] WASCA 288 (2 December 2003) [26].

39 Seddon, above n 19, 115; Nonggorr, above n 33, 170; Warnick, above n 33, 889; Enid Campbell, 'Legislative Approval of Government Contracts' (1972) 46 *Australian Law Journal* 217, 217-218.

40 *Cf Placer Development Ltd v Commonwealth* (1969) 121 CLR 353.

41 Petrillo and Connor, above n 1, 338-340.

42 Bruno Zeller, 'Good Faith — Is it a Contractual Obligation?' (2003) 15(2) *Bond Law Review* 215.

43 Adopted by legislation in all US States except Louisiana which has adopted it only in part: Bill Dixon, 'Good Faith in Contractual Performance and Enforcement - Australian Doctrinal Hurdles' (2011) 39 *Australian Business Law Review* 227, 229.

44 American Law Institute, *Restatement (Second) of Contracts* (1981). Though this is not a statute, it is treated as authoritative in US courts.

45 978 A 2d 651 (Md, 2009).



townhouses. When Questar requested that a more expensive carpet be installed, CB Flooring submitted a change order that increased the contract price. Questar refused to adjust the contract and purported to terminate the contract under a TC clause.<sup>46</sup> The Maryland Court of Appeals held that a TC power that could be exercised for any reason at all could render a contract illusory.<sup>47</sup> However, the Court found that such a result was avoided because an implied obligation of good faith limited the use of the TC clause.<sup>48</sup> The Court in this case implied an obligation of 'good faith and fair dealing' into a private contract between private parties.

Similar standards apply to government contracts where a government body purports to exercise its TC power. In *Torncello*<sup>49</sup> the US Navy purported to use a TC clause to terminate a contract for pest control services in order to have the work done in-house at a cheaper price. A plurality of the Court of Claims applied a 'changed circumstances test' and held that the TC power was exercised improperly.<sup>50</sup> Bennett J noted that limits to a TC clause were necessary in order to prevent the government's promises from being rendered illusory.<sup>51</sup>

Notably, later cases, such as *Krygoski Construction Company v United States*,<sup>52</sup> have abandoned the 'changed circumstances' test in favour of the less stringent 'bad faith or abuse of discretion' test.<sup>53</sup>

---

46 Note that Questar actually wrongfully terminated the contract for breach but, under the contract, wrongful termination for cause was deemed to be termination for convenience.

47 *Questar*, 978 A 2d 651, 670 (Md, 2009).

48 *Ibid* 670-671. It is well established in Maryland that all contracts are subject to a duty of good faith: *Clancy v King*, 954 A 2d 1092, 1106 (Md, 2008).

49 681 F 2d 756 (Ct Cl, 1982).

50 *Ibid* 763.

51 *Ibid* 760. See also *RAM Engineering & Construction Inc v University of Louisville*, 127 SW 3d 579, 586 (Ky, 2003).

52 94 F 3d 1537 (Fed Cir, 1996).

53 The 'changed circumstances' test allows a contractor to challenge the exercise of a TC power by showing there were no changed circumstances surrounding the contract that warranted early termination. The 'bad faith or abuse of discretion' test, however, requires a contractor to undertake the more difficult task of showing the government exercised its TC power in bad faith or in abuse of its discretion. See *Custom Printing Co v United States*, 51 Fed Cl 729 (Fed Cl, 2002); *Northrop Grumman Corporation v United States*, 46 Fed Cl 622 (Fed Cl, 2000); *T&M Distributors Inc v United States*, 185 F 3d 1279 (Fed Cir, 1999); *Salsbury Industries v United States*, 905 F 2d 1518 (Fed Cir, 1990); Scott McCaleb, 'Searching for a Needle in a Haystack: Conflicts in the Federal Circuit's Government Contracts Jurisprudence' (2001) 11 *Federal Circuit Bar Journal* 705, 713.

It is difficult for contractors to show that a TC clause has been used in bad faith. In government contracts, in particular, there is a presumption that government officials acted in good faith and ‘well-nigh irrefragable proof’ is required to show otherwise.<sup>54</sup> US courts have upheld the use of TC clauses for a broad range of reasons, including defective plans and specifications,<sup>55</sup> compliance with legislative mandate or judicial injunction,<sup>56</sup> and substantial deterioration of the parties’ working relationship.<sup>57</sup> It has also been suggested that a TC clause could be used where there are budget constraints, where the government makes changes in the strategic planning for public programs, or where there are unexpected technological advances that render contracts for old technology redundant.<sup>58</sup>

### B *The Position in Australia*

An implied duty of good faith is not as well established in Australia as it is in the US. There is some concern that such an implied duty interferes with the will of the parties, freedom of contract, and the notion that contractual obligations must be voluntarily assumed.<sup>59</sup> The High Court has not yet settled whether Australian contract law should recognise an implied obligation of good faith.<sup>60</sup> The content and method of implying a term of good faith is, therefore, uncertain and is contested by a number of academics.<sup>61</sup>

---

54 *Krygoski Construction Company v United States*, 94 F 3d 1537, 1541 (Fed Cir, 1996); Bryan O Ramos, ‘Never Say Die: The Continued Existence of the Government Officials’ Good Faith Presumption in Federal Contracting Law and the Well-Nigh Irrefragable Proof Standard After *Tecom*’ (2009) 63 *Air Force Law Review* 163.

55 *Nolan Bros Inc v United States*, 405 F 2d 1250, 1253 (Ct Cl, 1969).

56 *Government Systems Advisors Inc v United States*, 21 Ct Cl 400, 410 (Ct Cl, 1990) where a TC clause was used in compliance with congressional mandate; *Salsbury Industries v United States*, 905 F 2d 1518 (Fed Cir, 1990) where a TC clause was used in compliance with an injunction that required the contract to be awarded to another bidder.

57 *Linan-Faye Construction Co Inc v Housing Authority of City of Camden*, 847 F Supp 1191 (D NJ, 1994); *Embrey v United States*, 17 Ct Cl 617, 624-625 (Ct Cl, 1989). See also *Dalton Properties Inc v Jones*, 683 P 2d 30 (Nev, 1984) where a contract was terminated after the contractor was accused of stealing appliances from the apartments it was cleaning.

58 Michael Garson, ‘Krygoski and Termination for Convenience: Have Circumstances Really Changed?’ (1997-1998) 27 *Public Contract Law Journal* 117, 123; *Questar*, 978 A 2d 651, 674 (Md, 2009).

59 See Angelo Capuano, ‘Not Keeping the Faith: A Critique of Good Faith in Contract Law in Australia and the United States’ (2005) 17(1) *Bond Law Review* 29, 44; *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45, 75-76 (Kirby J).

60 See *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45.

61 See generally Howard Munro, ‘The “Good Faith” Controversy in Australian Commercial Law: A Survey of the Spectrum of Academic Legal Opinion’ (2009) 28 *University of Queensland Law Journal* 167.

In addition, Australian case law does not give much guidance on good faith as a limit on TC clauses. In *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* ('*GEC Marconi*'),<sup>62</sup> a clause which was entitled 'Termination for Convenience' stated that 'BHP IT may terminate this [contract] in whole or in part, by notifying the BTM in writing'.<sup>63</sup> Finn J accepted, in obiter, that such a TC clause would be subject to an obligation of good faith.<sup>64</sup> In *Kellogg Brown*,<sup>65</sup> Australian Aerospace ('AA') supplied the government with military helicopters and subcontracted some of the work to Kellogg Brown. Disputes arose between the parties and AA gave written notice of termination under a TC clause.<sup>66</sup> Hansen J held that there was a serious question to be tried as to whether a term of good faith applied to this clause. The dispute was, however, subsequently settled out of court.

In Australia, as in the US, government contracts are treated differently to private contracts. Finn J in *Hughes Aircraft Systems International v Airservices Australia*,<sup>67</sup> recognised that the government should be held to higher standards of conduct as a model contractor and 'should be required as of course to act fairly towards those with whom it deals at least in so far as this is consistent with its obligation to serve the public interest'.<sup>68</sup> It is suggested that an implied term of good faith should be more readily applied to government contracts. Interestingly, a government contract that has been elevated to legislative status may also be subject to the principles of administrative law.<sup>69</sup> This could mean that a government purporting to exercise a TC power under statute will not be able to do so where relevant considerations were not taken into account or an improper purpose in an administrative law sense is involved.

### C *The Content of a Duty of Good Faith*

Although there is no definitive statement as to the content of a duty of good faith in Australia, a number of cases have approved Sir Anthony Mason's extra-curial statements<sup>70</sup> recognising three main elements:

---

62 (2003) 128 FCR 1.

63 Ibid 171.

64 Ibid 174.

65 [2007] VSC 200 (15 June 2007).

66 Ibid [10].

67 (1997) 76 FCR 151.

68 Ibid 196.

69 See Seddon, above n 1, 118-119.

70 Sir Anthony Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66, 69 based on comments made in a speech delivered in 1993.

- 1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);
- 2) compliance with honest standards of conduct; and
- 3) compliance with standards of contract which are reasonable having regard to the interests of the parties.<sup>71</sup>

It would appear that a duty of good faith may provide some limits to the use of a TC clause.

## 1 *Co-operation*

Co-operation concerns the obligation on each party to remain loyal to a contract by doing all that is necessary to enable the other party to have the benefit of the contract.<sup>72</sup> Peden likens this duty to Burton's 'forgone opportunities' approach.<sup>73</sup> According to this approach, parties necessarily forego certain opportunities when they enter into a contract. A party behaves in 'bad faith' when it ignores the justified expectations of the other party by attempting to regain those lost opportunities.<sup>74</sup>

It may, therefore, be a breach of good faith to exercise a TC power in order to pursue a cheaper contract price. However, it must be noted that a party to a contract is not expected to subordinate its own legitimate interest to the interests of the other party.<sup>75</sup> It is, therefore, conceivable that a government may exercise a TC power in good faith where the cost of the contract can no longer be justified with respect to the public interest.

A principal could legitimately exercise a TC power in situations where it is in the best interests of both parties to do so. A TC power could, for example, be exercised where contractual relations must be re-arranged because one of the parties has undergone corporate restructuring. It could also be exercised where the cost of performing the contract has inflated significantly and has become a burden on both parties.<sup>76</sup>

---

71 Ibid quoted with approval in, for example, *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349, 367; *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, 570; *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* [2010] WASCA 222 (22 November 2010) [49].

72 *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596, 607.

73 Elisabeth Peden, 'The Meaning of Contractual "Good Faith"' (2002) 22 *Australian Bar Review* 235, 237-238.

74 Ibid; Steven Burton, 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1980) 94 *Harvard Law Review* 369.

75 *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 17 (31 January 2002) [67]; *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 [147].

76 Lawrence Lerner, 'Tying Together Termination for Convenience in Government Contracts' (1979-1980) 7 *Pepperdine Law Review* 711, 720.

It appears that a duty to ‘co-operate’ will not be breached where a principal exercises its TC power because the relationship between the contracting parties has broken down. Finkelstein J in *Garry Rogers Motors (Aus) Pty Ltd v Subaru (Aus) Pty Ltd*<sup>77</sup> recognised that

[m]any relationships can only operate satisfactorily if there is mutual confidence and trust. Once that confidence and trust has broken down the position is not easily restored. It is not unconscionable to terminate a relationship where that trust and confidence has been undermined.<sup>78</sup>

## 2 Honesty and Proper Purpose

Honesty is relevant where a party’s contractual right or power can only be exercised on the condition that the party holds a certain belief. If, for example, a contract states that a principal may terminate the contract if performance is not to its ‘reasonable satisfaction’, then the principal can only terminate the contract if it genuinely holds this belief.<sup>79</sup> Honesty is therefore linked to the notion that a contractual power must be genuinely exercised for a proper purpose.

For example, in *Burger King Corporation v Hungry Jack’s Pty Ltd*,<sup>80</sup> a franchise agreement gave Burger King the ‘sole discretion’ to grant or refuse approvals for the development of Hungry Jack’s restaurants. The contract listed a number of factors that were relevant to the approvals. All of the factors concerned the productivity of the proposed restaurants. The Court found that Burger King refused the approvals, not because it believed the new restaurants would be unproductive, but because it intended to expand and develop its own restaurants in Australia.<sup>81</sup> It was held that Burger King breached its obligation of good faith because its actions were for an improper purpose.<sup>82</sup>

Concepts of honesty and proper purpose might not, however, be an effective limit on a widely drawn TC clause if the contract does not indicate that the principal must take into account any particular considerations before terminating the contract.<sup>83</sup> In some situations however, a head contractor may request a TC clause be inserted into a subcontract so that the termination of the head contract can flow down

77 [1999] ATPR ¶41-703.

78 Ibid ¶43-016.

79 *Deemcope Pty Ltd v Cantown Pty Ltd* [1995] 2 VR 44, 59 (Coldrey J).

80 (2001) 69 NSWLR 558.

81 *Burger King Corporation v Hungry Jack’s Pty Ltd* [2001] NSWCA 187 (Unreported, Sheller, Beazley and Stein JJA, 21 June 2001) [310].

82 Ibid [223], [250], [306], [307], [368].

83 See *Sundararajah v Teachers Federation Health Limited* [2011] FCA 1031 (2 September 2011) [63], [69].

to the subcontract.<sup>84</sup> If this is the case, a court may determine that the TC clause in the subcontract should only be used when the head contract is terminated. If the subcontractor exercises its TC power for some other reason, it may be regarded as an improper purpose.

### 3 Reasonableness

A number of Australian cases have equated good faith with an obligation of reasonableness.<sup>85</sup> In *Renard Constructions (ME) Pty Ltd v Minister for Public Works*<sup>86</sup> ('*Renard*'), a clause in a construction contract gave the principal the right to require a contractor who was in default for delays to show cause as to why the contract should not be terminated. The principal's agent, who was unaware that the principal had contributed to the delays, exercised his power to terminate the contract. The Court held that the decision to terminate the contract breached an implied obligation of reasonableness because it was based on unfairly misleading information. Priestley JA likened this obligation of reasonableness to an obligation of good faith.<sup>87</sup>

Kuehne observes that what is meant by 'reasonableness' is unclear but, at the very least, requires reasonableness in the *Wednesbury* sense.<sup>88</sup> This standard would restrain a party to a contract from making a decision so unreasonable that no reasonable person would have made it.<sup>89</sup> Such a standard could prevent a principal from using a TC clause capriciously, or for irrational reasons, or in the context of unjustified discriminatory treatment against a particular contractor.

#### D Excluding an Implied Duty of Good Faith

Although an implied duty of good faith may provide some limits to a TC power, such a duty can easily be excluded by the express intention of the parties. In *Pacific Brands Sport & Leisure Pty Ltd v Underworks*

---

84 See *Kellogg Brown* [2007] VSC 200 (15 June 2007).

85 See *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 263 ('*Renard*'); *Burger King* (2001) 69 NSWLR 558; *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 (20 February 2004); *Mangrove Mountain Quarries Pty Ltd v Barlow* [2007] NSWSC 492 (17 May 2007) [27].

86 (1992) 26 NSWLR 234.

87 *Ibid* 263.

88 Geoffrey Kuehne, 'Implied Obligations of Good Faith and Reasonableness in the Performance of Contracts: Old Wine in New Bottles?' (2006) 33 *University of Western Australia Law Review* 63, 104-106.

89 See *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1KB 223; *Paragon Finance Plc v Staunton* [2002] 2 All ER 248.

*Pty Ltd*,<sup>90</sup> Finkelstein J accepted that an obligation of good faith was present in every commercial contract ‘unless the duty is either excluded expressly or by necessary implication. The duty cannot override any express or unambiguous term which is to a different effect.’<sup>91</sup>

### 1 *Exclusion by Express Terms*

One way that parties to a contract may exclude an implied term of good faith is to expressly exclude all implied terms from the contract. In *Vodafone Pacific Ltd v Mobile Innovations Ltd*<sup>92</sup> (*‘Vodafone Pacific’*), the contract provided that ‘[t]o the full extent permitted by Law and other than as expressly set out in this Agreement the parties exclude all implied terms’.<sup>93</sup> Giles JA held that such a clause effectively excluded an implied term of good faith.<sup>94</sup>

Paterson also argues that it is open to contracting parties to target specific duties and expressly exclude good faith in particular.<sup>95</sup> Dixon suggests the following formulation:

the discretionary right in question [as the case may be] is not subject to the expectations, ‘reasonable or otherwise’, of the parties to the contract and that any action taken pursuant to the provision is ‘deemed to be exercised in good faith’.<sup>96</sup>

Kuehne, however, notes that attempts to expressly exclude good faith may be ‘commercially injurious’ because it may indicate an intention to act in bad faith.<sup>97</sup>

Another possible avenue for excluding good faith could be the inclusion of an ‘entire agreement’ clause. In *NT Power Generation Pty Ltd v Power and Water Authority*,<sup>98</sup> Mansfield J held that an ‘entire agreement’ clause was sufficient to exclude an implied term of good faith.<sup>99</sup> However, in

---

90 [2005] FCA 288 (22 March 2005). Affirmed in *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* (2006) 149 FCR 395.

91 *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 (22 March 2005) [64].

92 [2004] NSWCA 15 (20 February 2004).

93 *Ibid* [198].

94 *Ibid*.

95 Jeannie Marie Paterson, ‘Implied Fetters on the Exercise of Discretionary Contractual Powers’ (2009) 35 *Monash University Law Review* 45, 69.

96 Bill Dixon, ‘Can the Common Law Obligation of Good Faith Be Contractually Excluded?’ (2007) 35 *Australian Business Law Review* 110, 121 quoting O’Byrne, S K, ‘Good Faith in Contractual Performance: Recent Developments’ (1995) 74 *Canadian Bar Review* 70, 96.

97 Kuehne, above n 88, 99.

98 (2001) 184 ALR 481.

99 *Ibid* 571.



*Hart v MacDonald*,<sup>100</sup> Isaacs J noted that an ‘entire agreement’ clause could not exclude implications that arise on a fair construction of the agreement because such implications are as much a part of a contract as any express terms.<sup>101</sup> Finn J in *GEC Marconi*<sup>102</sup> was also of the view that an ‘entire agreement’ clause should not be sufficient to exclude an obligation of good faith. It is suggested that parties intending to exclude a term of good faith should express such an intention as clearly as possible.

## 2 *Inconsistency with Express Terms*

If the express terms of a contract are inconsistent with an implied obligation of good faith, the express terms prevail.<sup>103</sup> By their very nature TC clauses tend to be drafted in a way that gives a principal a very broad power to terminate a contract. Where a TC clause clearly gives a principal an absolute discretion to terminate, there can be no room to imply limitations, such as a duty of good faith, to fetter that discretion.

In *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*,<sup>104</sup> a contract contained a clause allowing the principal to terminate the contract ‘at its option, at any time and for any reason it may deem advisable’. The contract also contained an express good faith clause that applied to the carrying out of the work, the derivation of rates, and the interpretation of the contract. The WA Supreme Court of Appeal, held that a duty of good faith did not apply to the termination of the contract because the principal’s termination power was ‘clear and unambiguous’ and provided the principal with ‘an absolute and uncontrolled discretion which it was entitled to exercise for any reason it might deem advisable’.<sup>105</sup>

Similarly, in *Vodafone Pacific*,<sup>106</sup> a distribution agreement gave Vodafone ‘the sole discretion’ to set sales levels for its distributor. The NSW Court of Appeal held that this discretion was not limited by an obligation of reasonableness. According to Giles JA the words ‘sole discretion’ ‘weigh

---

100 (1910) 10 CLR 417.

101 *Ibid* 430.

102 (2003) 128 FCR 1, 209.

103 Regarding terms implied by law, see *Castlemaine Toobey's Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, 492. Regarding terms implied in fact, see *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 286.

104 (2000) 16 BCL 130.

105 *Ibid* 170-171. This point was approved in *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2003) 16 BCL 255. See also *Apple Communications Ltd v Optus Mobile Pty Ltd* [2001] NSWSC 635 (26 July 2001) [16]-[17].

106 [2004] NSWCA 15 (20 February 2004).



against the implied obligation of good faith and reasonableness in the exercise of the power'.<sup>107</sup>

It is clear from these cases that a TC clause stating that the principal may terminate the contract 'in its sole discretion' or 'at any time and for any reason' will not be subject to an implied term of good faith. It is less clear, however, if a TC clause does not include these kinds of phrases and only states that the principal can 'terminate for convenience' or can 'terminate by written notice'. In these cases, there is more room for a court to find an implied term of good faith does apply.<sup>108</sup>

The recent interlocutory decision in *Sundararajah v Teachers Federation Health Limited*<sup>109</sup> should be noted. In that case, a private health fund agreed to pay members' benefits directly to a dental clinic by using an electronic system known as the HICAPS system. Due to complaints about the dental services provided and concerns that the clinic was over-claiming benefits, the health fund purported to terminate the agreement. It relied on a clause stating 'a Fund may... end this agreement to the extent that it relates to that Fund on the giving of 90 days' notice'. Foster J held that the clause conferred a 'broad unqualified power' to terminate the contract and an implied duty of good faith was inconsistent with the contract's terms.<sup>110</sup> His Honour did not, however, consider the comments made in *GEC Marconi* and *Kellogg Brown* suggesting TC clauses may be subject to a good faith obligation.<sup>111</sup> In any case, Foster J held that even if a duty of good faith did apply, the health fund would not be in breach.<sup>112</sup>

### 3 A Non-Excludable Duty

Seddon and Ellinghaus suggest that a term of good faith should be treated as a 'universal term' or 'core obligation' that cannot be completely excluded from a contract.<sup>113</sup> They note that, in *Vodafone Pacific*,<sup>114</sup> Giles JA left open the issue as to 'whether or when an implied term of good

---

107 Ibid [195]. Cf *Burger King* (2001) 69 NSWLR 558 where the 'sole discretion' to exercise a contractual power was limited by a list of factors in the contract that were relevant to the power.

108 See above n 59-63 and accompanying text regarding *GEC Marconi* (2003) 128 FCR 1; *Kellogg Brown* [2007] VSC 200 (15 June 2007).

109 [2011] FCA 1031 (2 September 2011).

110 Ibid [69]-[70].

111 *GEC Marconi* (2003) 128 FCR 1, 174; *Kellogg Brown* [2007] VSC 200 (15 June 2007).

112 *Sundararajah v Teachers Federation Health Limited* [2011] FCA 1031 (2 September 2011) [72]-[76].

113 N C Seddon and MP Ellinghaus, *Cheshire and Fifoot's Law of Contract* (LexisNexis Butterworths, 9th ed, 2008) 459-460.

114 *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 (20 February 2004).

faith so far as it precludes arbitrariness, capriciousness or abuse of power can be excluded.<sup>115</sup> Seddon and Ellinghaus argue that this leaves open the possibility that the express terms of a contract cannot completely exclude an obligation of good faith.<sup>116</sup>

Such a position, however, requires the courts to imply an obligation of good faith as a non-excludable, mandatory rule. In *GEC Marconi*,<sup>117</sup> Finn J recognised that Australian courts ‘do not have the facility, for example, to treat the duty [of good faith] as simply a mandatory rule of contract law as do many European legal systems.’<sup>118</sup> The duty of the court is to determine the intention of the parties from the words of the contract. If the words of a contract are unambiguous, the court must give effect to them regardless of whether the result appears capricious or unreasonable.<sup>119</sup>

## V THEORETICAL CONCERNS

A carefully drafted TC clause will allow a principal to terminate a contract at any time, for any reason. This kind of flexibility is at odds with the certainty and predictability that is at the heart of ‘classical contract theory’. It is suggested that ‘reliance theory’ and ‘relational contract theory’ provide a more accurate account of how a contract that contains a TC clause actually works.

### A *The Model of the Typical Contract*

In his article, ‘Contracts, Promises and Obligations’,<sup>120</sup> Atiyah summarises the model of the ‘typical contract’ as it is described by countless law texts to explain the nature of contract law.<sup>121</sup> To paraphrase, the ‘typical contract’ is a bilateral executory agreement—it is a contract formed by the exchange of promises. Provided that the rules of contract formation are satisfied, a contract generally comes into existence at the point where the promises are exchanged. From that point, each party must either perform their side of the bargain as promised or pay damages in lieu of

---

115 Ibid [194].

116 Seddon and Ellinghaus, above n 113, 459-460.

117 (2003) 128 FCR 1.

118 Ibid 208.

119 *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99, 110 (Gibbs J).

120 P S Atiyah, ‘Contracts, Promises, Obligations’ in P S Atiyah (ed) *Essays in Contract* (1986, Clarendon Press). This is a revised version of an earlier paper: Atiyah, PS, ‘Contracts, Promises and the Law of Obligations’ (1978) 94 *Law Quarterly Review* 193.

121 Ibid 12.

performance.<sup>122</sup> Atiyah observes that these damages 'represent the value of the innocent parties' disappointed expectations even though he [or she] has not relied upon the contract in anyway, and even though the defendant has received no benefit under it.'<sup>123</sup>

### B *Promises in a Contract Containing a TC Clause*

Contracts containing TC clauses depart from this model of the typical contract because the principal may choose to terminate the contract at will without having to pay the contractor damages for loss of anticipatory profits. The value of the contract is not pre-determined and the principal is not locked into a bargain. This raises questions as to the nature of the promises underlying a contract containing a TC clause.

According to classical contract theory, the source of contractual obligations is the parties' intention to voluntarily assume obligations.<sup>124</sup> Parties may voluntarily assume obligations through the exchange of promises. In a contract containing a TC clause, the principal promises the contractor compensation for services rendered and, at least in government contracts, compensation for other incurred costs. As discussed above, this is enough to ensure the contract is backed by consideration and is enforceable.

However, the principal may invoke the TC clause at will. This means that, though there is a binding contract, the principal has not made a real promise to give the contractor any compensable work at all. The principal may terminate the contract at any time. Ardal observes that a person makes a 'promise' when he or she makes an overt representation that he or she will do something in the future.<sup>125</sup> Since a TC clause affords great flexibility to a principal, it is questionable whether the principal has made a real promise to bind its future action.

---

122 'Efficient breach theory' also gives this ultimatum to contractual parties: Nina C Z Khouri, 'Efficient Breach Theory in the Law of Contract: An Analysis' (2000-2003) 9 *Auckland University Law Review* 749, 749. Note that this ultimatum may be tempered by equitable remedies: *Coulls v Bagot's Executor & Trustee Co Ltd* (1967) 119 CLR 460, 504.

123 Atiyah, above n 120, 12.

124 Michel Rosenfield, 'Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory' (1984-1985) 70 *Iowa Law Review* 769, 825-826.

125 Pall S Ardal, 'Ought We to Keep Contracts Because They Are Promises?' (1983) 17 *Valparaiso University Law Review* 655, 658.

### C *Reliance Theory*

Atiyah argues that contractual obligations are better understood in terms of reliance as opposed to promises.<sup>126</sup> He suggests that many simple transactions such as boarding a bus or purchasing goods from a supermarket cannot be sensibly characterised as exchanges of promises.<sup>127</sup> For example, when a passenger boards a bus and buys a ticket, the bus driver does not make an overt representation or express promise that they will safely drive them to a certain destination in return for the money. Such a promise is artificially implied into the transaction. For Atiyah, such a transaction is better understood in light of the ‘reliance theory’ of contract. According to this theory, the bus driver’s obligation to carry the passenger arises, not because of some implied promise the driver is deemed to have made, but because the passenger has detrimentally relied on the driver by paying for the ticket.<sup>128</sup> The obligation to carry the passenger prevents the driver from retaining an underserved benefit from the passenger’s reliance.

In a contract that contains a TC clause, the principal may terminate the agreement at will and, in effect, does not promise any work to the contractor. The basis of the principal’s obligations may be better explained in terms of reliance. It is suggested that the written agreement between the parties outlines their relationship and stipulates how any work under the contract should be performed. When a contractor performs work for the principal in accordance with the written agreement, the contractor detrimentally relies on the agreement. This gives rise to the principal’s liability to compensate the contractor for its work. Although the principal does not guarantee the contractor any work, the principal assumes responsibility for the contractor’s reliance on the agreement—for the work actually done under the contract.

### D *Relational Contract Theory*

One criticism of classical contract theory is that it assumes contracts are ‘discrete’ transactions made in a perfect spot market where strangers come to a bargain, perform the agreed exchange, and then walk away.<sup>129</sup> Macneil argues that the problem with this view is that, in reality, contracts are not just about exchanges. They are also about

---

126 Atiyah, above n 120, 19.

127 Ibid.

128 See Brian Coote, ‘The Essence of Contract: Part 1’ (1988) 1 *Journal of Contract Law* 91, 105.

129 See Ian R Macneil, *Contracts: Exchange Transactions and Relations* (Foundation Press, 1978) 12-13.

relationships.<sup>130</sup> 'Relational contract theory' asserts that contracts may be viewed on a spectrum.<sup>131</sup> On one end of the spectrum, are highly 'discrete' contracts such as, for example, the purchase of liquor from a store that one does not expect to visit again.<sup>132</sup> On the other end of the spectrum, are highly 'relational' contracts such as long term projects where the parties must co-operate and maintain a relationship in order to perform the contract.<sup>133</sup> These are the kind of contracts that contain TC clauses.

Macneil argues that classical contract theory is concerned with predictability and therefore aligns itself with 'discrete' contracts.<sup>134</sup> The act of exchanging promises is an act of future planning which is much more achievable in the context of a 'discrete contract' because the parties are more likely to be in a position to give certainty to their agreement.<sup>135</sup>

In a 'relational' contract, however, where a long term relationship is involved, it may be unrealistic for the parties to detail their contractual promises by settling the precise terms of their agreement at the point of contract formation. Relational contract theory recognises the need for flexibility in the performance of the contract.<sup>136</sup> This flexibility can be achieved by inserting a TC clause that may be used as a risk allocation tool that allows the parties to respond to changes in their relationship and changes to the market as they perform their contractual obligations.

## VI CONCLUSION

This article has explored the validity of contracts containing a TC clause and the limits which the notion of good faith may impose upon the broad termination power of a TC clause. A carefully drafted TC clause

---

130 Ian R Macneil, 'Relational Contract Theory: Challenges and Queries' (2000) 94 *Northwestern University Law Review* 877, 878, 884.

131 *Ibid* 894-896.

132 This example comes from Oliver Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' (1979) 22 *Journal of Law and Economics* 233, 247.

133 See Bill Dixon, 'Common Law Obligations of Good Faith in Australian Commercial Contracts — A Relational Recipe' (2005) 33 *Australian Business Law Review* 87, 94.

134 Ian R Macneil, 'Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law' (1977-1978) 72 *Northwestern University Law Review* 854, 862-864.

135 See J M Feinman, 'Relational Contract Theory in Context' (1999-2000) 94 *Northwestern University Law Review* 737, 742: 'implementation of planning... [is] especially important in contracts with strong discrete elements'.

136 See Macneil, 'Adjustment of Long-Term Economic Relations', above n 134, 862-864.

will be upheld by the courts and will provide the principal with the flexibility to terminate a contract without any cause or reason. The duty of good faith, which may operate to limit the broad termination power of TC clauses, does not, however, appear to impose significant limits, and can in any case be excluded by the express intention of the parties.