Termination for Convenience, the Doctrine of Executive Necessity and Government Contracting: Implications for Commonwealth Agencies such as Defence

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Abstract

All Australian Government agencies are involved in some form of commercial contracting. As the largest procurement agency in the Commonwealth, the Australian Defence Force ('ADF'), for example, engages in a large number of commercial contracts to satisfy its military equipment, supply and service needs. As an organ of the Crown, the ADF enjoys a restricted executive power to terminate such contracts wherever necessary without consequence. This power is also reflected in the 'termination for convenience' ('TFC') clauses that are typically included in Defence contracts but which include compensatory provisions for innocent contractors. This article considers the implications of the executive necessity doctrine and TFC clauses for Government contracting using Defence as the agency of example, and attempts to resolve some important questions that arise from these features of government contracting.

Keywords

Contract Law; Defence; Executive Necessity; Government; Termination for Convenience

I INTRODUCTION

In financial year 2016-17, the Commonwealth Government engaged in a total of 64 092 commercial contracts, the majority being for commercial, military and private vehicles as well as management, administrative, building and construction services.[1] The Australian Defence Organisation ('Defence'), incorporating both the Australian Defence Force ('ADF') and the civilian Department of Defence, is 'the largest procurement agency in the Commonwealth and is responsible for some of Australia's most

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[1] Australian Government, Department of Finance, *Statistics on Australian Government Procurement Contracts* (17 November 2017) Department of Finance <https://www.finance.gov.au/procurement/statistics-on-commonwealth-purchasing-contracts/>.

complex procurement activities'.[2] Defence's acquisition of military equipment, supplies and services is facilitated through the use of contracts with various parties from industry both in Australia and abroad.[3] Most of these contracts are standard form and feature in the Australian Standard for Defence Contracting ('ASDEFCON') and Commonwealth Contracting ('CC') suites of tendering and contracting templates.

Whilst the ordinary rules of contract law generally apply to government contracts,[4] including those within the ASDEFCON and CC suites, there are additional legal principles that apply only to government contracts or which are more commonly utilised in agreements between government entities and non-government parties. This reflects the fact that 'the law applying to government contract decisions belongs to the equivocal zone where private law and public law meet'.[5]

Two legal doctrines of importance in government contracting, which aptly demonstrate this curious intersection between private and public law, are *executive necessity* and *termination for convenience*. These doctrines are shrouded by legal uncertainty, and yet may have enormous implications for a government agency's dealings with contract parties. This article does not seek to defend or condemn the doctrines. Rather, it seeks to provide clarity for government agencies such as Defence to assist their contractual activities by examining the most recent and relevant case law considering some of the more notable uncertainties plaguing these doctrines. Leading academic opinion is also consulted to provide a holistic perspective on the issues examined. The insights in this article may assist in minimising risk and avoiding unwanted liability.

II The Doctrine of Executive Necessity

The doctrine of executive necessity is a general principle of law stipulating that 'a public authority cannot preclude itself from exercising important discretionary powers or performing public duties by incompatible contractual or other undertakings'.[6] The doctrine is said to originate in the early English decision of *Rederiaktiebolaget Amphitrite v The King*,[7]

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[2] Department of Defence (Cth), *Procurement and Contracting in Defence* <http://www.defence.gov.au/dmo/DoingBusiness/ProcurementDefence/>. Department of Defence acquisitions account for 69 percent of the total value of Commonwealth procurement contracts: see Department of Finance (Cth), above n 1.

[3] This article focusses upon conventional contracts between Defence and industry entities and does not consider other forms of agreement such as Status of Forces Agreements (SOFAs) or Mutual Logistics and Services Agreements (MLSAs).

[4] Nicholas Seddon, *Government Contracts: Federal, State and Local* (The Federation Press, 5th ed, 2013) 7.

[5] Margaret Allars, 'Administrative Law, Government Contracts and the Level Playing Field' (1989) 12 *University of New South Wales Law Journal* 114, 114.

[6] *Ansett Transport Industries (Operations) Pty Ltd v Commonwealth* (1977) 139 CLR 54, 74 (Mason J) ('*Ansett*').

[7] [1921] 3 KB 500 ('*Amphitrite*').

which centred on a dispute arising out of the First World War. As a consequence of intensified blockades of British ports by the Germans, the British Government forged an arrangement with the governments of neutral countries whereby their ships would be allowed to leave British ports only if they were replaced by other ships of the same tonnage. The plaintiff, a Swedish shipping company, applied in writing for an exemption. The British Government issued a written notice stipulating that the plaintiff's ship could leave the UK provided that it arrived with a minimum of 60 percent approved goods (which it did), before subsequently refusing to release it. The plaintiff sued the Crown for breach of contract. The Crown alleged that the contract was not enforceable.

Rowlatt J expressed what is now a time-honoured principle that

> it is not competent for the Government to fetter its future executive action, which must necessarily be determined by the needs of the community when the question arises. It cannot by contract hamper its freedom of action in matters which concern the welfare of the State.[8]

Given the circumstances of war, it was essential that the Crown not be inhibited by a private contractual undertaking from performing its executive duties when required. Consequently, the British Government's agreement with the plaintiff could not be enforced. Rowlatt J's view was endorsed by Mason J in *Ansett Transport Industries (Operations) Pty Ltd v Commonwealth*,[9] where his Honour noted the existence of a general principle of law that the government could not preclude itself from 'exercising important discretionary powers or performing public duties by incompatible contractual or other undertakings'.[10]

Whilst the executive necessity doctrine arose out of the unique context of war, the courts have since expressed it in more generic terms.[11] Rowlatt J's ratio in *Amphitrite* and Mason J's endorsement in *Ansett* both suggest that the doctrine more broadly safeguards the Crown's general capacity to escape agreements that inhibit its ability to act in matters of public interest.[12] The notably broad scope of the doctrine has been criticised both judicially[13] and academically.[14]

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[8] Ibid 503.
[9] *Ansett* (1977) 139 CLR 54.
[10] Ibid 74.
[11] William Dixon, 'Termination for Convenience or Not?' (2017) 45(3) *Australian Business Law Review* 229, 230. The author cites *Ansett* (1977) 139 CLR 54 in support of the proposition that the doctrine of executive necessity 'has been accepted as a general doctrine and broadly applied by the High Court of Australia'.
[12] As discussed further on, such matters are not necessarily restricted to situations of warfare.
[13] See, eg, *Ansett* (1977) 139 CLR 54, 74; *Commonwealth v Hooper* (1992) 2 Aust Contract Reports ¶90–010, 89, 287–89.
[14] See, eg, Allars, above n 5; P W Hogg, 'The Doctrine of Executive Necessity in the Law of Contract' (1970) 44 *Australian Law Journal* 154; E Campbell, 'Agreements about the Exercise of Statutory Powers' (1971) 45 *Australian Law Journal* 338.

However, as Wright has observed, the Crown's various privileges and immunities have, since the 16th century, never been absolute.[15] Indeed, they have been progressively eroded by statute or through the effect of judicial interpretation over time. For example, it was once near impossible for the Crown to be bound by a statute absent express provision.[16] However, the High Court in *Bropho v Western Australia*[17] held that the Crown could be bound by statute by necessary implication, and that this implication might more readily occur in contemporary times in light of the Commonwealth's increasingly frequent commercial activities.[18] An additional example is the abolition of the Crown's immunity from suit by the Federal, State and Territory governments from 1903.[19] The Crown is not necessarily immune from suit purely because of its executive power over the land and its subjects.

In light of these and many other developments eroding the Crown's many powers and privileges over time, the survival of the executive necessity doctrine feeds into the larger enquiry as to whether it remains a necessary and appropriate feature of the Crown's suite of executive powers in modern times. Although this enquiry is beyond the scope of this article, a brief comment might be made. Termination of a contract on the basis of executive necessity must, as will be discussed further on, be justifiable in the circumstances. The Commonwealth cannot break contracts on a whim, but can only do so where public interests or needs, or the proper application of discretionary powers, render such action *essential*. There must be a reasonable basis for this conclusion, just as there must be such a basis for a finding that a statute binds the Commonwealth. Though perhaps more anomalous than other Crown powers, the doctrine is thus subject to limitations which arguably curtail the risk of its impulsive employment or abuse.

Moreover, as will be explained in due course, enforcement of termination for convenience clauses – which effectively reduce the power granted by the executive necessity doctrine to a contractual clause – is the more common method by which the government exercises this executive power. These clauses are a common feature of commercial government contracts and generally impose additional obligations on the Commonwealth to

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[15] Robertson Wright, 'The Future of Derivative Crown Immunity – With a Competition Law Perspective' (2007) 14 *Competition and Consumer Law Journal* 240. See also Anthony Gray, 'Immunity of the Crown from Statute and Suit' (2010) 9 *Canberra Law Review* 1.
[16] The High Court in *Bropho v Western Australia* (1990) 171 CLR 1, 19 noted that an 'eye of the needle' test had been stringently applied.
[17] (1990) 171 CLR 1.
[18] Ibid 19-20.
[19] *Judiciary Act 1903* (Cth) s 64; *Court Procedures Act 2004* (ACT) s 21; *Crown Proceedings Act 1993* (NT) s 5; *Claims Against the Government and Crown Suits Act 1912* (NSW) s 4; *Crown Proceedings Act 1980* (Qld) s 8; *Crown Proceedings Act 1972* (SA) s 10; *Supreme Court Civil Procedure Act 1932* (Tas) s 64; *Crown Proceedings Act 1958* (Vic) s 23; *Crown Suits Act 1947* (WA) s 5.

ensure that it does not escape consequence for its decision to inappropriately terminate a contract.

Whatever its merits, the doctrine of executive necessity has been accepted into Australian law for some time although instances of its invocation are somewhat rare.[20] The consequences for contractors whose agreements are terminated for a government agency's convenience can be significant; in the defence context, it is the contractor who is invariably engaged to supply Defence, and Defence which opts to exercise the right to terminate. The contractor will likely have overlooked other commercial opportunities and channelled its resources into securing the Defence contract.[21] Indeed, the contractor may have already commenced work.[22] Termination for convenience can occur even where there has been no wrongdoing on the contractor's part and is therefore likely to cause considerable financial losses and practical inconveniences for the contractor.[23] Moreover, as explained further on, the executive necessity doctrine does not oblige Defence (or any government agency) to pay damages on termination.[24] To fully understand the practical and legal implications of this doctrine for agencies such as Defence, however, it must be discussed in conjunction with the related concept of termination for convenience.

III TERMINATION FOR CONVENIENCE

A common feature in many government contracts, including ASDEFCON and CC template contracts[25] is a termination for convenience ('TFC') clause. A TFC clause is typically unilateral in that it benefits the

[20] One of the few attempts, which was ultimately unsuccessful, occurred in *New South Wales Rifle Association Inc v Commonwealth of Australia* (2012) 266 FLR 13. This case is discussed later in the article.

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

[22] Seddon, above n 4, 278.

[23] Pederson notes that one way contractors can effectively immunise against this risk is to factor the possibility of the government's non-performance into its costings when tendering for government contracts: Marc Pederson, 'Rethinking the Termination for Convenience Clause in Federal Contracts' (2001) 31(1) *Public Contract Law Journal* 83, 94. See also Julie Roin, 'Public-Private Partnerships and Termination for Convenience Clauses: Time for a Mandate' (2013) 63 *Emory Law Journal* 283, 285. Seddon notes that the contractor may be restricted to restitutionary doctrines when seeking relief: Seddon, above n 4, 278.

[24] As explained later in the article, however, it is plausible that Defence may be ordered to pay damages in particular circumstances even where the executive necessity doctrine has been relied upon.

[25] See, eg, Department of Defence (Cth), *Australian Standard for Defence Contracting ('ASDEFCON') Suite of Tendering and Contracting Templates* <http://www.defence.gov.au/casg/DoingBusiness/ProcurementDefence/ContractingWithDefence/PoliciesGuidelinesTemplates/ContractingTemplates/asdefcon.aspx> (Strategic Materiel) s 13.4; (Standing Offer for Goods) s 11.3; (Services) s 10.3; (Shortform Services) s 17; (Purchase Order and Contract: Form SPO20) s 16. See also Department of Finance (Cth), *Commonwealth Contract Terms* <https://www.finance.gov.au/procurement/commonwealth-contracting-suite/ > C.C.15.

government and not the other contracting party. Generally speaking, a TFC clause permits the government to break a contract for any reason in the nature of an exigency or a significant practical necessity (such as a change in governmental policy), without consequence. It is essentially a contractual manifestation of the executive necessity doctrine.[26] TFC clauses are often said to have originated in the United States during the post-Civil War era.[27] In *Torncello v United States*,[28] the US Court of Claims explained how such clauses 'originated in the reasonable recognition that continuing with wartime contracts after the war was over clearly was against the public interest'.[29] It was regarded as essential that procuring agencies had the power to 'settle contracts that have been subjected to great changes in expectations'.[30] As such, the TFC clause provided a simple mechanism by which to promptly wind down armament production.

Typically, TFC clauses include compensatory provisions stipulating that the aggrieved party will receive compensation for all losses and expenses incurred up to the point of termination and as a consequence of the termination itself, but not for any anticipated profits on the contract. The following example comes from cl 16 of the ASDEFCON Form SPO20 (General Conditions of Contract for the Supply of Goods and Repair Services):[31]

> In addition to any other rights it has under the Contract, the Commonwealth may at any time terminate the Contract by notifying the Supplier in writing. If the Commonwealth issues such a notice, the Supplier must stop work in accordance with the notice, comply with any directions given by the Commonwealth and mitigate all loss, costs (including the costs of its compliance with any directions) and expenses in connection with the termination, including those arising from affected subcontracts.
>
> The Commonwealth will only be liable for payments to the Supplier for Supplies accepted in accordance with clause 7 before the effective date of termination and any reasonable costs incurred by the Supplier that are

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[26] *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200 (15 June 2007) [11] (Hansen J). The same was stated in a historical version of the Defence Procurement Policy Manual. See Department of Defence (Cth), *Defence Procurement Policy Manual*, Version 6.0 (2006) [8].

[27] See, eg, Pederson, above n 23, 87; Phil Evans. 'The Enforceability of Termination for Convenience Clauses' (Paper presented at the World Building Congress, Brisbane, 5-9 May 2013) 2.

[28] 681 F. 2d 756 (Ct. Cl, 1982).

[29] Ibid 764.

[30] Ibid. The Court made reference to the earlier case of *United States v Corliss Steam-Engine Co* 91 US 321 (1876).

[31] Department of Defence (Cth), *Australian Standard for Defence Contracting ('ASDEFCON') Suite of Tendering and Contracting Templates* http://www.defence.gov.au/casg/DoingBusiness/ProcurementDefence/ContractingWithDefence/PoliciesGuidelinesTemplates/ContractingTemplates/asdefcon.aspx (Purchase Order and Contract: Form SPO20).

> directly attributable to the termination, if the Supplier substantiates these amounts to the satisfaction of the Commonwealth.
>
> The Supplier will not be entitled to profit anticipated on any part of the Contract terminated.

The TFC clause contained in cl C.C.5 of the CC Terms similarly states that the supplier 'will not be entitled to loss of anticipated profit for any part of the Contract not performed'.[32] What is unique about a TFC clause, as distinct from the executive necessity doctrine, is that – depending upon the particular wording of the clause – invocation of the former may oblige the Commonwealth to pay compensation whereas reliance upon the executive necessity doctrine does not.[33] As Monichino rightly notes, such clauses are typically construed quite narrowly; courts interpret their meaning in the context of the contract as a whole and with due regard to the relevant factual matrix at hand.[34] Put simply, the TFC clause should not be seen as an unlimited discretionary power to terminate a valid contract. Rather, as will be discussed shortly, the Australian courts have developed a series of principles that closely govern the lawful invocation of TFC clauses in any given case.

Given the significant powers conferred upon the government by the executive necessity doctrine and TFC clauses, numerous questions arise that may have significant practical importance for agencies such as Defence. This article now considers some of these questions.

IV MUST A TFC CLAUSE BE EXERCISED REASONABLY OR IN 'GOOD FAITH'?

The courts, and indeed most contractors who enter into contracts with the government (including Defence), are all too aware of the unique challenges and constraints affecting the government. As Carberry and Johnstone note, the 'budgetary constraints and national security considerations applicable to defence contracts require the government to be permitted greater flexibility in entering and exiting contracts than private parties'.[35] TFC clauses epitomise, and facilitate, this need. An interesting question is whether there are any limitations on the manner in, or purposes for which, such clauses must be invoked. It is conceivable, for example, that Defence or any other agency may invoke the clause to serve some ulterior purpose outside of what might typically be regarded as anticipated governmental

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[32] Department of Finance (Cth), *Commonwealth Contract Terms* <https://www.finance.gov.au/procurement/commonwealth-contracting-suite/ > C.C.5.

[33] This issue is considered in greater depth later in the article.

[34] Albert Monichino, 'Termination for Convenience: Good Faith and Other Possible Restrictions' (2015) 31 *Building and Construction Law Journal* 68, 69.

[35] Glenn T Carberry and Philip M Johnstone, 'Waiver of the Government's Right to Terminate for Default in Government Defense Contracts' (1988) 17 *Public Contract Law Journal* 470, 471.

contingencies. An example might be freeing itself from a less favourable deal in order to pursue a more advantageous one, as compared to escaping pre-existing arrangements in response to a change in government.

The US courts appear to endorse the view that a TFC clause can be exercised quite liberally and need not be in response to some cardinal change in circumstances.[36] That being said, the termination must be shown to have been in 'the government's interest' under s 2.101 of the Federal Acquisition Regulation 2005 (FAR). Situations in which a termination has been deemed to be in the government's interest include: where the supplies or services in question are no longer needed;[37] where critical government services rely upon a restructure of contractual arrangements;[38] where the contractor unreasonably refuses to agree to a contract modification;[39] where the contracted work has become too costly;[40] or where the relevant branch of the Defence Force is seeking to avoid a conflict with the legislature.[41] The termination must essentially have been in good faith and not a clear abuse of discretion.[42] Allegations that the government has not acted in good faith require 'well-nigh irrefragable proof' in support, otherwise the presumption that public officials act conscientiously in the discharge of their duties remains.[43]

Whereas under US law a termination for convenience must only be effected where it is in 'the government's interest', there are Australian authorities suggesting that the doctrine of executive necessity, as encapsulated within a TFC clause, should only be invoked in response to 'some overriding public interest, such as the exigencies of war'.[44] In all other cases, the Commonwealth might be said to have contravened its ostensible duty of good faith (and therefore acted in 'bad faith').[45] Yet Australian courts have

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[36] See generally, eg, *T & M Distributors Inc v United States* 185 F 3d 1279, 1284 (Fed Cir, 1999).
[37] *United States v Corliss Steam-Engine Co* 91 US 321 (1876).
[38] *Northrop Grumman Corporation v United States* 46 Fed Cl 622 (2000).
[39] *Saltwater, Inc.* B-293335.3 (GAO, 26 April 2004).
[40] *Krygoski Construction Company Inc v United States* 94 F 3d 1537 (Fed Cir, 1996).
[41] *Schlesinger v United States* 390 F.2d 702 (Ct. Cl, 1968).
[42] See, eg, *John Reiner & Co v United States* F 2d 438, 442 (1963); *Salsbury Industries v United States* 905 F 2d 1518, 1521 (Fed Cir, 1990); *Caldwell & Santmyer Inc v Glickman* 55 3d 1578, 1581 (Fed Cir, 1995).
[43] *Kalvar Corp v United States* 543 F 2d 1298, 1301 (1976).
[44] *Northern Territory v Skywest Airlines Pty Ltd* (1987) 90 FLR 270, 294.
[45] There are several Australian authorities supporting the proposition that a party's exercise of a contractual power for an extraneous purpose (other than the purpose for which it was it was vested in the party) may contravene an implied duty of good faith. See, eg, *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228 (15 September 2005). Where, however, the nature and terms of a contract clearly indicate that one party enjoys an unfettered discretion with respect to the exercise of certain powers under the contract, an implied term of good faith may be excluded: *Vodafone Pacific Ltd v Mobile Innovations* [2004] NSWCA 15 (20 February 2004); *Trans Petroleum (Australia) Pty Ltd v White Gum Petroleum Pty Ltd* [2012] WASCA 165 (23 August 2012). It is acknowledged that actions

unhelpfully failed to reach consensus on this point. This is largely due to confusion as to what the duty of good faith actually requires of contractual parties.[46] It is sometimes said that the duty mandates cooperation between the parties in achieving the contractual objectives, and compliance with honest and reasonable standards of conduct (having regards to the interests of the parties).[47] In *BAE Systems Australia Ltd v Cubic Defence New Zealand Ltd*,[48] however, Besanko J opined that such a duty would not qualify the right to exercise a TFC clause where the relevant circumstances calling for its enforcement arose.[49]

The courts have also tended to define the duty of good faith in either *positive* terms, such as an obligation to be loyal to the terms of the contract[50] and act honestly with restraint upon self-interest,[51] or in *negative* terms, in the sense of a prohibition against acting in bad faith.[52] For present purposes, it is suggested that capriciously or improperly enforcing a TFC clause might be regarded by the courts as contrary to the obligation of good faith.

A series of cases suggest that there is no implied obligation to exercise a TFC clause in good faith where the wording of the clause or the circumstances suggest that this would be inconsistent with the intentions of the parties. For example, it was suggested in *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*[53] that there was no requirement for Placer to invoke the relevant TFC clause in good faith given that it conferred on Placer 'an absolute and uncontrolled discretion which it was entitled to exercise for any reason it might deem advisable'. The implication of such a requirement was inconsistent with Placer's express authority to terminate the contract 'at its option, at any time and for any reason it may deem advisable'.[54] Consequently, there was no obligation to have regard to

challenging a government agency's termination for convenience have rarely succeeded: Pederson, above n 23, 84.

[46] As Seddon, Bigwood and Ellinghaus observe, '[m]uch ink has been spilt in attempting to assign a definite content to the duty to act in good faith': Nick Seddon, Rick Bigwood and Manfred Ellinghaus, *Cheshire and Fifoot: Law of Contract* (Butterworths, 10th Australian ed, 2012) 469.

[47] Anthony Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66, 69. The courts often refer to this statement when attempting to define the boundaries of the good faith doctrine; see, eg, *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* (2010) 41 WAR 318, 348.

[48] (2011) 285 ALR 596.

[49] Ibid 612–13.

[50] *South Sydney District Rugby League Football Club Ltd v News Ltd* [2000] FCA 1541 (3 November 2000) [426].

[51] *Aiton Australia Pty Ltd v Transfield Pty Ltd* (1999) 153 FLR 236, 264.

[52] *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Overlook v Foxtel* [2002] NSWSC 17 (31 January 2002) [68]–[71].

[53] (2000) 16 BCL 130, 171 ('*Placer*').

[54] Ibid 170–1.

Thiess' interests when terminating the agreement as this would effectively have undermined the very power conferred by the TFC clause.[55]

A similar conclusion was reached in *Sundararajah v Teachers Federation Health Ltd*,[56] where Foster J approved of the following statement from McDougall J in *Tomlin v Ford Credit Australia*:[57]

> [W]here 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 are inconsistent with a constraint on the exercise of that power by considerations of reasonableness or good faith.

Further, in *Starlink International Group Pty Ltd v Coles Supermarkets Australia Pty Ltd*,[58] the New South Wales Supreme Court regarded 'the very notion of there being no necessity for a cause or a reason' prior to the invocation of a TFC clause as being inconsistent with the view that the party seeking to exercise the power was not entitled to act according to their own idiosyncrasies.[59] That is, by its nature, the TFC clause did not oblige the party invoking its operation to do so reasonably or in good faith.

In other cases, however, the courts have determined that TFC clauses must be exercised in good faith. Finn J in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*[60] considered such an obligation 'to go without saying' in light of the distinctive nature of TFC clauses.[61] Unfortunately his Honour did not provide further insight into this analysis. The case of *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd*[62] is also instructive in this discussion given its relevance to Defence contracting and broader application to government contracts generally. The defendant, Australian Aerospace ('AA'), contracted with the Commonwealth for the supply of 46 MRH 90 helicopters. AA subcontracted Kellogg to perform some acquisition, training and support work as part of the head contract. The subcontract contained a TFC clause which mirrored the one in the head contract. One year into the contract, AA gave Kellogg written notice under the TFC clause citing delays and the subsequent prospect of default. Kellogg contended that AA was invoking the clause in bad faith and not for the bases alleged, before successfully

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[55] The court did, however, conclude that the express good faith provision included within the contract required the parties to act in good faith in relation to general interpretation and performance of the contract (so as to achieve its objectives), as opposed to its termination: *Placer* (2000) 16 BCL 130, 170. Moreover, it should be noted that this was a private sector case involving a mining venture between two companies. As such, the principles enunciated in this case are not necessarily applicable to government contracts.
[56] (2011) 283 ALR 720, 731.
[57] [2005] NSWSC 540 (10 June 2005), [119].
[58] [2011] NSWSC 1154 (27 September 2011).
[59] Ibid [30].
[60] (2003) 128 FCR 1.
[61] Ibid 174.
[62] [2007] VSC 200 (15 June 2007).

applying for an interlocutory injunction preventing AA from terminating for convenience.

Hansen J concluded that there was sufficient evidence to support the view that AA had terminated the contract so as to derive a material benefit.[63] AA had apparently subcontracted the most lucrative parts of the contract to Kellogg, and the evidence suggested that AA sought to recover these parts and complete the work itself for profit. Hansen J stated that the existence and scope of an implied obligation to exercise the TFC clause in good faith was therefore 'a serious question to be tried' and that the case for the same was 'well arguable'.[64] Reference was made to the Defence Procurement Policy Manual ('DPPM') of the time, which stated that any TFC clause should be invoked 'in good faith and in accordance with the principle of fair dealing'.[65] Though the matter never returned to the Victorian Supreme Court for a full hearing, the outcome still supports the view that TFC clauses must be exercised in good faith.

In *New South Wales Rifle Association Inc v Commonwealth of Australia*,[66] White J stated: 'The fact that [a] contract is with the Government does not displace an obligation of good faith and reasonableness. If anything, that is a factor in favour of the implication of the term'.[67] The inference here is that a TFC clause must necessarily be exercised reasonably or in good faith merely by virtue of the fact that the contract is with the Crown. In that case, the Association operated a rifle range upon Commonwealth land in return for an annual licence fee. The contract contained a TFC clause empowering the Commonwealth to terminate the contract by written notice. Another clause stipulated that the Association would be deemed in default if the Commonwealth issued it with a remedial notice requiring any breaches to be remedied 'within fourteen days or such longer time as is specified in the notice', and this obligation was not satisfied. Three such notices were issued, requiring the Association to remedy alleged disrepair of leased premises upon the rifle range. It would have been impossible for the Association to carry out all of the repair work within the times specified in the notices. The Commonwealth subsequently sought to terminate.

The Association commenced proceedings arguing, amongst other things, that the Commonwealth had acted in bad faith by stipulating an unreasonably short period of time to remedy the defects and subsequently purporting to terminate the contract. It was determined that the

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[63] Ibid [61].
[64] Ibid.
[65] Ibid [60]. This statement does not appear in the most recent edition of the Defence Procurement Policy Manual: see Department of Defence (Cth) *Defence Procurement Policy Manual* <http://www.defence.gov.au/casg/DoingBusiness/ProcurementDefence/ContractingWithDefence/PoliciesGuidelinesTemplates/ProcurementPolicy/dppm.aspx>.
[66] (2012) 266 FLR 13 ('*Rifle Association*').
[67] Ibid 37.

Commonwealth was required to exercise its powers to set the time for remediation of the defects and terminate the contract in good faith.[68] This was not the case, as the Commonwealth's objective was to reclaim the land and escape the licence agreement, which inspired its unreasonable stipulations under the remedial notices. The Commonwealth was restrained by injunction from terminating the licence.

The existence and bounds of the 'good faith' obligation in relation to TFC clauses thus remain unclear. A selection of cases appear to limit the scope of the executive necessity doctrine, and permissible uses of TFC clauses (by extension), to the 'exigencies of war'. A termination in response to such exigencies would therefore be regarded as being carried out in good faith. Other authorities suggest that a change in government policy generally will not justify the termination of a contract on the basis of executive necessity,[69] nor will a desire to escape the agreement in order to engage another (usually cheaper) contractor to complete the work.[70] In such cases, the termination may be regarded as having been carried out in bad faith. The courts may, in future cases, draw an analogy between acceptable uses of executive power to terminate for necessity and acceptable uses of contractually-conferred power to terminate for convenience. Academic commentary provides alternative views. It is said, for example, that TFC clauses can only be invoked where 'required by the national interest (including the national economy)'[71] or where 'public policy calls for non-compliance'.[72]

As such, best practice requires government agencies such as Defence to exercise their power under a TFC clause in good faith and for a proper and reasonably justifiable purpose in order to minimise litigation on this point. Moreover, a reputation of disloyal and obdurate behaviour will make the prospect of contracting with the Commonwealth most unattractive from the perspective of commercial parties. The Commonwealth, as a 'model contractor', should be – and indeed *is* – held to higher standards of conduct. Wherever consistent with its obligation to serve the public interest, the Commonwealth should 'act fairly towards those with whom it deals'.[73]

V Is the Power to Terminate for Convenience Implied Where There is No Contractual Stipulation?

In *L'Huillier v Victoria*,[74] Callaway J appeared to suggest that government contracts should be taken as impliedly including a term permitting the

[68] Ibid 43.
[69] Ibid 35.
[70] See generally *Carr v JA Berriman Pty Ltd* (1953) 89 CLR 327.
[71] Colin Turpin, *Government Contracts* (Penguin Books, 1972) 242.
[72] Peter Hogg, Patrick Monahan and Wade Wright, *Liability of the Crown* (Carswell, 4th ed, 2011) 305.
[73] *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151, 196.
[74] [1996] 2 VR 465 ('*L'Huillier*').

government to terminate where it is necessary for the government to exercise its executive discretion.[75] The basis for such implication was unclear, though his Honour's reference to government contracts containing 'public law discretions' as a class suggests that the term would be implied in law and not in fact.[76] Such a term would, save for any guidance as to compensation for the non-terminating party, have the effect of a TFC clause. Under US law, this position is effectively mandated by virtue of the 'Christian Doctrine', which provides that a government contract is taken to include clauses deemed mandatory under any statute or regulation 'carrying the force and effect of law', even where such a clause is absent.[77] The doctrine has been subsequently refined by the US courts and held only to apply to 'mandatory contract clauses which express a significant or deeply ingrained strand of public procurement policy'.[78] As Pederson explains, this sets a low bar and TFC clauses are routinely implied into government contracts by virtue of the Christian Doctrine.[79]

There is no such doctrine under Australian law, nor any Australian case law conclusively supporting the concept of automatic implication of a TFC clause in government procurement contracts. It is conceivable for such implication to occur 'in fact' in a given case, though it would need to satisfy the established test in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*.[80] Lord Simon expressed the five criteria to be satisfied as follows:

> [F]or a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

There would arguably be a reasonable and equitable basis to imply a TFC clause into a government procurement contract; without it, for example, Defence or any government agency would be bound to a contract that they may no longer require or which is no longer optimal, and thus public funds would be wasted. There is however a compelling counterargument here that the very one-sided nature of the TFC clause renders it distinctly inequitable; this asymmetry might be so significant that a court considers

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[75] Ibid 481.
[76] Ibid 480-81.
[77] *G. L. Christian & Assoc. v United States* 312 F 2d 418, 424 (Ct Cl, 1963). In most cases, the Federal Acquisition Regulation ('FAR') mandates inclusion of a TFC clause: see, eg, Part 49 – Termination of Contracts. Being a federal regulation, TFC clauses would therefore be deemed to form part of government contracts even if not expressly included.
[78] *General Engineering & Machine Works v O'Keefe* 991 F 2d 775, 779 (Fed Cir, 1993).
[79] Pederson, above n 23, 92. *Christian* itself is a case where a TFC clause was deemed to be such a clause expressing a significant or deeply ingrained strand of public procurement policy,
[80] (1977) 180 CLR 266, 283.

it unreasonable. A TFC clause would theoretically give business efficacy to a Defence contract for essentially the same reasons that it might be regarded as reasonable and equitable. The unique nature of procurement processes necessarily requires a tailored approach to the performance and termination of government contracts. Additionally, a TFC clause could be seen as an obvious inclusion from the perspectives of both Defence and its contractors given the commonly-known challenges and constraints affecting the military. Experience shows that a TFC clause can be clearly expressed through careful drafting, and it would hardly contradict any express terms given it is designed to permit Defence to terminate the contract and dismiss those very terms at its convenience (subject to any stipulations as to compensation and surviving obligations).

Given that the *BP Refinery* test implies terms in fact on the basis of the presumed intentions of the parties,[81] the preceding analysis assumes the parties in a given setting intended to include a TFC clause in their particular contract. Yet, as mentioned earlier, Callaway J in *L'Huillier* appeared to refer to *all* government contracts (as a class) as impliedly containing a term permitting the government to terminate on the basis of executive necessity. This would be implication *in law* for which there is a different test. This test is premised not upon the intentions of the parties but upon policy considerations. The test requires two things to be established: (1) an identifiable class of contractual relationship between the parties; and (2) that the term in question is appropriate for implication into all contracts of said class.[82]

The 'class' of contractual relationship here will differ depending upon the particular government agency in question, though in the case of Defence, for example, the relevant relationship would be between Defence and its contractors. The term to be implied is a TFC clause, but would it be deemed 'appropriate' for implication into all Defence contracts by an Australian court? The relevant question is whether 'the enjoyment of the rights conferred by the contract would or could be rendered nugatory, worthless, or, perhaps, be seriously undermined' without the term being implied.[83] It must be shown that the contract would be 'deprived of its substance, seriously undermined or drastically devalued'.[84]

It is true that there is a great variety of contracts in the ASDEFCON and CC suites, and not all contain TFC clauses.[85] The same can likely be said

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[81] *The Moorcock* (1889) 14 P.D. 64, 68; *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 283; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352-3.

[82] See Mark Giancaspro and Colette Langos, *Understanding Contract Law: A Practical Guide* (LexisNexis, 2016) 182–4.

[83] *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 450.

[84] Ibid 453.

[85] See, eg, *Department of Defence* (Cth), *ASDEFCON (Standing Offer for Goods and Maintenance Services)*

of the many different kinds of contract tailored to each specific government agency. This would certainly make identification of the relevant 'class' of contract difficult. In the case of Defence contracts *generally*, however, it is arguable that omission of a TFC clause would undermine *all* such contracts by failing to provide a tangible contractual basis upon which Defence could exercise its executive powers to escape or rescale those contracts (of any kind and magnitude) wherever public policy or practical necessity required. If Defence did not have this flexibility within its agreements with contractors, then its obligation to procure essential goods and services at the best value and for critical defence purposes at any given time would be considerably undermined.

Implication of any clause in law must be 'justified functionally by reference to the effective performance of the class of contract to which [it applies], or of contracts generally in cases of universal implications'.[86] It would seem essential given the unique nature and purpose of Defence contracts for them to contain a TFC clause to accommodate the various exigencies of war. An analogous argument could likely be made where a government agency was able to demonstrate a sufficiently significant nexus between its functions and the need to promptly escape contractual commitments in response to political or other pressing factors. TFC clauses give textual form to the executive necessity doctrine; no other clause would, in the case of Defence, as effectively facilitate its use of executive power to amend or escape its contractual obligations.

It remains to be seen whether a court would imply a TFC clause into a Defence contract where one was not expressly included, as occurs in the US pursuant to the Christian Doctrine. There is arguably a case to imply such a term in fact or in law. Regardless, best practice would likely be to expressly include a TFC clause stipulating the compensation payable to the contractor in the event of its use. This would eliminate any doubt as to the scope of Defence's executive powers and, provided the clause were used for appropriate purposes, would likely discourage legal disputes where a contract was terminated for convenience. Fortunately, almost all Defence template contracts, including the most commonly used varieties, contain a TFC clause. Any that do not should be reviewed in light of the obvious advantages of inclusion.

<http://www.defence.gov.au/casg/DoingBusiness/ProcurementDefence/ContractingWithDefence/PoliciesGuidelinesTemplates/ContractingTemplates/asdefconsogms.aspx>.

[86] *Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169, 189.

VI Can a Government Agency such as Defence Invoke a TFC Clause and then Utilise the Executive Necessity Doctrine?

There is no known authority conclusively answering this question. Given that a TFC clause typically requires compensation to be paid to the contractor, there would certainly be an economic motive for Defence and all organs of government to invoke the executive necessity doctrine to circumvent the clause and avoid this liability. There is no known case where this has been attempted by an Australian government or its agencies. As a starting point, the common law appears to suggest that the Crown can by express contractual provision waive a selection of its own privileges and immunities.[87] However, it would be questionable whether the presence of the TFC clause in the contract would by implication amount to a waiver of Defence's right to subsequently utilise the executive necessity doctrine.

In *Woodlands v Permanent Trustee Co Ltd*, [88] it was held that the New South Wales Government was not bound by the former *Trade Practices Act 1974* (Cth) ('TPA')[89] despite being privy to various contracts with private sector companies and borrowers under the ill-fated HomeFund scheme. This was on the basis of the *Bradken* doctrine, which provides that the Crown is not bound by statute unless it is expressly named or it can be necessarily implied that it was intended to be bound.[90] It was argued, on the basis of Canadian authority, that the Crown could not accept the benefit of a law without also accepting its burdens (the 'benefits' here were being able to participate in the marketplace whereas the 'burdens' were the liabilities that would potentially have applied under the TPA).

The Federal Court held that the New South Wales Government had not taken advantage of the TPA 'in any direct sense' and that the most that could be said was that it 'had the benefit of a marketplace governed by the Act, among other legislation'.[91] The stipulations in the New South Wales Government's various contracts with private sector companies and borrowers that it was acting in its commercial – rather than public – capacity, and that it was not immune to legal proceedings, did not displace its Crown privilege under the *Bradken* doctrine. Put simply, there was no 'waiver' of executive power.

The reasoning in *Woodlands* could imply that Defence, as an arm of the Crown, would not be bound by any contractual provision which purported to displace the privilege it enjoys under the executive necessity doctrine. It is arguable, then, that the inclusion of a TFC clause in a contract would not

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[87] See the discussion and authorities cited in Seddon, above n 4, 235–40.
[88] (1996) 139 ALR 127 ('*Woodlands*').
[89] Now the *Competition and Consumer Act 2010* (Cth).
[90] See *Bradken Consolidated Ltd v Broken Hill Pty Ltd* (1979) 145 CLR 107.
[91] *Woodlands* (1996) 139 ALR 127, 140.

amount to a waiver of the Crown's entitlement to exercise these powers. It is submitted, however, that a court would condemn Defence for such action and potentially bar its reliance upon the executive necessity doctrine. The Crown 'must display some minimum respect for the law'.[92] Accordingly, where it has committed itself to an obligation under contract, and where that obligation expressly restricts the Crown's executive power, a court is likely to take the view that the Crown should be held to its word.[93] Public policy would weigh heavily in favour of this outcome.

For a variety of reasons, Defence should never sidestep its contractual obligation to pay compensation under a TFC clause by leaning on the executive necessity doctrine. For one, such conduct would be inconsistent with Defence values. One of those core values is 'integrity', which is described as acting honestly, ethically, and demonstrating 'the highest standards of probity' in conduct.[94] Objectively, evading express contractual obligations – no less one to pay compensation to a contractor who suffers loss through Defence's termination for convenience – would hardly be characterised as ethical or honourable. The same could be said of other government agencies generally; honourable and ethical conduct would be expected from any agency of an elected government. Secondly, such behaviour would almost certainly have commercial repercussions; contractors would likely be disinclined to contract with Defence (or any other agency) knowing that it may well terminate the deal for convenience and avoid paying compensation even where required to do so under the agreement. As Seddon notes:

> Apart from the legal conundrums that the doctrine poses, a government that too readily resorted to this doctrine would be well advised to think again because of the very important practical matter of its reputation in the market place.[95]

Finally, the legal conundrums Seddon mentions are numerous. A court is likely to look very unfavourably upon Defence or any other government agency if it acts in the manner described. Some analogies may be drawn with situations where a contract contains a 'force majeure' clause yet the party seeking to escape the contract alleges the contract has nonetheless been frustrated. Provided that the clause does not expressly and sufficiently address the consequences arising from the occurrence of the allegedly frustrating event, there will still be scope for the doctrine of frustration to apply.[96] Where, however, a force majeure clause clearly covers the event

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[92] *Administrative and Clerical Officers Association v Conn* (1988) 52 NTR 57, 62.
[93] Excluding situations where the particular privilege cannot be waived, such as parliamentary privilege: see *Rann v Olsen* (2000) 172 ALR 395.
[94] See the full list of Defence Values: Department of Defence (Cth), *Defence Values* <http://www.defence.gov.au/publications/defence_values.pdf>.
[95] Seddon, above n 4, 252.
[96] See, eg, *Bank Line Ltd v Arthur Capel & Co* [1919] AC 435; *Metropolitan Water Board v Dick Kerr & Co Ltd* [1918] AC 119. See also *J Lauritzen A S v Wijsmuller B V* [1990] 1

in question, the frustration doctrine will be excluded.[97] The effect of a TFC clause, however worded, is to enable government authorities such as Defence to exercise executive power and escape the contract for their convenience. It is arguable that it covers the same field which the executive necessity doctrine itself would cover. By analogy with cases considering the interrelationship between force majeure clauses and the doctrine of frustration, the TFC clause 'should not be ignored or read down'[98] given that it has ultimately foreseen the 'necessity'.

Of course, unlike the doctrine of executive necessity, the doctrine of frustration does not derive from the Crown's executive power. The very nature of the executive necessity doctrine is that it supersedes contractual fetters; it is not excluded by them. The analogy may therefore be tenuous. As explained earlier, however, it would certainly be in the best interests of all government agencies, including Defence, to exercise their power under a TFC clause in good faith and for a proper and reasonably justifiable purpose. Pleading executive necessity having already invoked a TFC clause (and thereby avoiding liability to pay compensation to the injured party) is, by any reasonably objective measure, an act of bad faith. The ramifications for so acting would potentially be significant, not only legally, but also commercially: government agencies would be seen as untrustworthy contractors and this could drastically affect their capacity to procure essential goods and services and provide the same to draw additional revenue.

VII Do Government Agencies such as Defence Need to Pay Damages for Terminating a Contract on the Basis of Executive Necessity?

There is very little case law addressing this question. In *Ansett*, Mason J suggested that damages should be paid where a government has terminated a contract on the basis of executive necessity, provided the contract was enforceable to begin with (that is, that it was not made beyond the scope of the Commonwealth's power and subsequently *ultra vires*).[99] This view was ostensibly supported by Callaway JA in *L'Huillier*.[100] These statements were, however, obiter and there is no known authoritative judicial

Lloyd's Rep 1; Ewan McKendrick, *Force Majeure and Frustration of Contract* (CRC Press, 2013) 34–6.

[97] See, eg, *Claude Neon Ltd v Hardie* [1970] Qd R 93; *Ange v First East Auction Holdings Pty Ltd* (2011) 284 ALR 638, 652; *PT Arutmin Indonesia v PT Thiess Contractors Indonesia* [2013] QSC 332 (6 December 2013) [163].

[98] Seddon, above n 4, 260.

[99] *Ansett* (1977) 139 CLR 54, 76–77.

[100] [1996] 2 VR 465, 478, 481. See also *Lumber Specialties Ltd v Hodgson* [2000] 2 NZLR 347 where the government was required to pay damages after a contract containing no compensatory provisions was overridden by legislation. In the context of legislative overriding, Australian law generally holds that compensation is not payable (see, eg, *South Australian River Fishery Association v South Australia* (2003) 85 SASR 373).

statement from an Australian court providing further guidance. There is certainly academic support for the suggestion that damages should be paid even where a contract is terminated on the basis of executive necessity and where the contract does not contain a TFC clause providing for compensation.[101] However, this literature will have only persuasive influence upon a court.

There are, however, contrary views. The ratio of Rowlatt J in *Amphitrite* is typically cited as the basis for the principle that the Crown need not pay damages for invocation of the executive necessity doctrine. In that case, his Honour stated:

> No doubt the Government can bind itself through its officers by a commercial contract, and if it does so it must perform it like anybody else or pay damages for the breach. But this was not a commercial contract; it was an arrangement whereby the Government purported to give an assurance as to what its executive action would be in the future in relation to a particular ship in the event of her coming to this country with a particular kind of cargo. And that is, to my mind, not a contract for the breach of which damages can be sued for in a Court of law.[102]

Yet interestingly, his Honour drew a distinction between commercial and non-commercial contracts, suggesting that breach of the former may indeed attract an obligation to pay damages. As Turpin notes, however, most government contracts – and certainly most Defence procurement contracts – would seemingly fit the description of 'commercial contract' given their direct relevance to the performance of executive functions:

> It might seem that procurement contracts would fall outside the scope of the principle, on the ground that in contracting for the supply of goods or services the Crown's future freedom of action is limited only in the sense that it binds itself to pay for what may turn out not to be needed. But this view does not take account of those major procurement contracts that involve a commitment of capital resources, facilities and skilled effort on the part of the government in the course of performance; such a contract, if binding, clearly places limits upon the government's freedom of action – in particular, to apply these resources to other purposes.[103]

Notwithstanding these lines of competing authority, the general position is that compensation is not payable by the government when it invokes the executive necessity doctrine. However, where a government or its agencies invokes the doctrine of executive necessity to escape a contract, it is plausible that a court may still order it to pay compensation where the supposed justification or 'necessity' is deemed insufficient. The limits of

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[101] See, eg, Hogg, above n 14, 155; Anthony Gray, 'Unfair Contract Terms: Termination for Convenience' (2013) 37(1) *University of Western Australia Law Review* 229, 250.
[102] *Amphitrite* [1921] 3 KB 500, 503.
[103] Turpin, above n 71, 21. See also Peter Turner, 'Sovereign Risk' (1993) *Australian Mining and Petroleum Law Association Yearbook* 135, 146 <http://www.austlii.edu.au/au/journals/AUMPLawAYbk/1993/9.pdf>.

the doctrine remain unclear but, as described above, there is Australian authority suggesting that it is narrowly confined only to matters of overriding public interest such as the exigencies of war. Although the existence of a requirement to act in good faith (i.e. in reliance upon an acceptable exigency and not some ulterior purpose) when invoking a TFC clause is unclear under Australian law, the courts have previously awarded damages for breach of the general duty of good faith in contract performance and in the exercise of contractual powers.[104] As such, a court may analogise the exercise of a TFC clause in bad faith with the exercise of a general contractual power in bad faith given the lack of practical distinction.

In cases where the Commonwealth has legislated and, in doing so, thwarted an existing contract, it has been made to pay damages. A pertinent example is *Heytesbury Properties Pty Ltd v City of Subiaco*,[105] where land owned by the City was leased to Heytesbury for manufacturing operations. Heytesbury sought to develop the land but required it to be rezoned from industrial to commercial and residential. The City amended the Town Planning Scheme (TPS) accordingly, with a proviso that all new approvals comply with Heytesbury's new development plan. Some time later, when Heytesbury sought to conduct a manufacturing business on the premises, the City refused the application deeming it inconsistent with the new TPS. By doing so, it precluded Heytesbury from complying with the provisions of its lease over the site.

The City argued that the doctrine of executive necessity permitted it to breach the lease agreements on the basis that its land planning processes could not be fettered by contractual undertakings. White J agreed with the City's argument but held it was nonetheless required to pay damages to Heytesbury.[106] The logical extension of this finding is that any reliance by the government upon the executive necessity doctrine to escape a contract may arguably attract an obligation to pay compensation to the injured contractor. After all, the law does not presume that contractors under a commercial agreement intend to provide their goods or services free of charge.[107] Support for White J's view in *Heytesbury* is also arguably implicit in the judgments of Mason J in *Ansett*,[108] McHugh J in *Suttling v*

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[104] See, eg, *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151; *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558; *Alstom Ltd v Yokogawa Australia Pty Ltd (No 7)* [2012] SASC 49 (2 April 2012).

[105] (1999) 108 LGERA 259 ('*Heytesbury*').

[106] Ibid 276. Note, however, that the City was found not to have breached the leases on appeal: *City of Subiaco v Heytesbury Properties Pty Ltd* (2001) 24 WAR 146. Cf *South Australian River Fishery Association v South Australia* (2003) 85 SASR 373.

[107] *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130, 151 (McHugh JA).

[108] See *Ansett* (1977) 139 CLR 54, 76–7.

Director-General of Education,[109] and Gillard J in *Arthurson v State of Victoria*.[110]

Moreover, as Loveranes notes, a contractor that engages in an agreement with the government may well rely upon its successful completion 'by relinquishing any opportunities for other work and by directing all of its resources to the performance of the contract'.[111] What contractor would not try to impress the government to place itself in a good position come the next tender? A court would likely take this level of commitment into account.

VIII Does the Absence of a Compensatory Provision in a TFC Clause Render the Contract Illusory (for Want of Consideration)?

It has been suggested, both judicially and academically, that the presence of a TFC clause in a contract renders the contract illusory for want of consideration. The foundation for this theory is the trite proposition under Anglo-Australian contract law that contracts must be supported by valuable consideration;[112] the parties must exchange (or promise to exchange) something of sufficient legal value in the eyes of the law.[113] This exchange must also constitute a 'bargain' in the sense that one party's promise to exchange a thing must be given *in return* for the other party's reciprocal promise to exchange a thing. As Lord Dunedin explained in *Dunlop Pneumatic Tyre Co Ltd v Selfridge and Co Ltd*: 'An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable'.[114]

In any contract to which a Commonwealth agency is a party and which contains a TFC clause, it can be argued that the Commonwealth, in effectively having the discretionary power to decide whether to perform its contractual obligations or not, is not providing consideration. By retaining the right, not afforded to the other party, to cancel the contract at any time, the Commonwealth's promise might be said to be illusory and lack mutuality.[115] There is international and Australian authority supporting this idea. In the old American case of *American Agricultural Chemical Co v Kennedy & Crawford*,[116] a contract under which the plaintiff vendor agreed

[109] (1985) 3 NSWLR 427, 449.
[110] [2001] VSC 244 (27 July 2001), [347]–[349].
[111] Loveranes, above n 21, 104.
[112] In *Currie v Misa* (1875) LR 10 Ex 153, 162 Lush J described valuable consideration as 'some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other'.
[113] *Thomas v Thomas* (1842) 2 QB 851, 859; 114 ER 330, 333–4.
[114] [1915] AC 847, 855.
[115] Kanwal Puri, *Australian Government Contracts: Law and Practice* (CCH Australia, 1978) 181.
[116] 103 VA. 171 (1904).

to sell fertiliser to the defendant purchasers was held to lack consideration and be unenforceable by virtue of a clause within the agreement worded as follows:

> We reserve the right to cancel this contract at any time we may deem proper, but in the event of such cancellation the provisions of this contract shall govern the closing of all business begun thereunder.[117]

The Supreme Court of Virginia held that as the defendant's engagement was to purchase the fertiliser upon the terms stated in the plaintiff's contract, and the effect of the cited term was that the contract did not bind the plaintiff to sell at all, there was no consideration for the defendant's promise.[118] A similar finding was reached in *Miami Coca-Cola Bottling Co v Orange Crush Co*,[119] where an exclusive licence for production of soft drink containing a proviso that the defendant licensor 'might at any time cancel the contract' was held to lack consideration and, therefore, contractual force.[120]

There are also Australian cases confirming that an overarching discretion to perform may indeed render a contract unenforceable for want of consideration. In *British Empire Films Pty Ltd v Oxford Theatres Pty Ltd*,[121] for example, a clause in a contract to supply films for exhibition provided that the distributor would not be liable for any failure to supply any of the films to the exhibitor. Given that the distributor was not actually bound to provide films, its promise to supply was illusory consideration for the exhibitor's reciprocal promise to purchase the films.[122] Similarly, in *MacRobertson Miller Airline Services v Commissioner of State Taxation of State Taxation (WA)*,[123] tickets issued by the appellant airline service were deemed to render the contracts of carriage created between the airline and passengers unenforceable. The tickets contained clauses stipulating that the airline could abandon any flights, cancel any tickets, take passengers only a portion of the way, or refuse to carry any passengers or baggage, without any reason. These unilateral powers were said to occupy all areas of possible contractual obligation.[124]

On one view, although none of these cases involved contracts with government agencies or TFC clauses (as strictly understood), analogies can be drawn. The principal reason for this is that these contracts were commercial in nature and involved the supply and acquisition of goods and services. Many government agency contracts will typically involve the

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[117] Ibid 174.
[118] Ibid 178.
[119] 296 F. 693 (1924).
[120] Ibid 694.
[121] [1943] VLR 163.
[122] Ibid 167–8.
[123] (1975) 8 ALR 131 ('*MacRobertson*').
[124] Ibid 136. See also *Gippsreal Ltd v Registrar of Titles and Kurek Investments Pty Ltd* (2007) 20 VR 157.

procurement of the same, and so these precedents are instructive. As such, it might be argued that contracts with Commonwealth agencies like Defence which contain TFC clauses are, on weight of authority, illusory for want of consideration.[125]

However, it is submitted that this argument is erroneous. None of the agreements in the cases mentioned included compensatory provisions.[126] It is the obligation to compensate the injured party upon enforcement of a TFC clause which contemporary judicial opinions and academic commentary suggest amounts to valid consideration and renders affected contracts enforceable. Scala, Lang and Browitt, for example note that compensatory provisions within TFC clauses, rather than rendering performance optional, 'permit 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)'.[127] This view is supported by numerous other commentators.[128]

There are also modern judicial opinions offering support for the suggestion that TFC clauses mandating payment of compensation will override the 'illusory consideration' argument. In *Biotechnology Australia Pty Ltd v Pace*,[129] McHugh JA noted that discretionary obligations would not be illusory for want of consideration where the discretion was required to be 'exercised within specified parameters', notwithstanding that one party had considerable latitude as to how it carried out those obligations.[130] A requirement within a contract to pay a $1 termination fee was described as 'critical' to the contract's validity in *Anderson Formrite Pty Ltd v Baulderstone Pty Ltd (No 7)*.[131] The TFC clause contained no compensatory component and so the arbitrary termination fee ensured that the party in whose favour the TFC clause operated had provided valid consideration.[132]

The most logical conclusion appears to be that the inclusion of a TFC clause in a government contract will not render the contract illusory (for want of consideration) provided it incorporates a requirement to pay some form of compensation to the injured party. This may, as in *Anderson*, be accomplished through a combination of interactive clauses, or more conveniently through inclusion within the TFC itself.

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[125] See, eg, Puri, above n 115, 181; Seddon, above n 4, 256.
[126] Although in *MacRobertson* there was a term within the carriage contract providing that passengers whose flights had been cancelled were entitled to a proportionate refund.
[127] John Scala, Paul Lang and Deborah Browitt, 'Termination for Convenience' (2008) 27 *Commercial Notes* 1, 2 (emphasis added).
[128] See, eg, Loveranes, above n 21, 107; Dixon, above n 10, 241–2; Seddon, above n 4, 256.
[129] (1988) 15 NSWLR 130.
[130] Ibid 151.
[131] [2010] FCA 921 (25 August 2010) [237] ('*Anderson*').
[132] Ibid [103]–[105].

IX CONCLUSION

The interrelationship between the doctrines of executive necessity and termination for convenience is complex and uncertain. The various agencies of government, including Defence, enjoy unique powers which permit them to free themselves from a contract without consequence where practical necessity, public policy, or, in the specific case of Defence, the exigencies of war so demand. This executive power is generally represented as a TFC clause in government contracts and invariably prescribes a requirement to provide compensation for losses suffered or expenses incurred by contractors as a result of the termination. The implications stemming from this unique interrelationship are numerous, and this article has sought to provide the firmest possible guidance for government, Defence, and contractors as to the probable legal positions in each scenario.

There appears to be a general hesitance on the part of Defence and government agencies generally to utilise the executive necessity doctrine to escape contracts; TFC clauses unsurprisingly offer a more favourable alternative. A contractual basis to terminate for convenience trumps an executive authority to do so for a variety of reasons including practicality and greater legal certainty, albeit at the cost of compensation to the contractor. Provided that Defence and all agencies utilise TFC clauses in good faith and for a proper and reasonably justifiable purpose, and comply with any directions therein as to compensation for the affected contractor, they would likely avoid any issues with liability. Best practice would be to expressly include TFC clauses in government contracts, as the law is unclear as to whether such a clause will be automatically implied by operation of law.

Defence and other agencies should avoid invoking the executive necessity doctrine if they have enforced a TFC clause; such behaviour is almost certain to attract negative judicial scrutiny if challenged in a court. In addition, although the accepted legal position appears to be that the government need not pay damages for escaping a contract based on executive necessity, there is ample authority for a court in the next case to suggest that it should do so.

As a concluding thought, government agencies should be very hesitant to utilise TFC clauses unless absolutely essential. Avoidance would likely amplify their reputation in the commercial marketplace and encourage competition. As Pederson states:

> By fully binding itself to its contractual commitments, subject to paying expectation damages in the event of its breach, the government would enhance the desirability of its contracts and, hence, the level of competition among prospective contractors. The resultant contract price reductions, in

> the aggregate, may outweigh any potential increase in damages that the Government may pay as a result of its occasional breach.[133]

The costs of termination for convenience may therefore feasibly outweigh the benefits.[134] Of course, if agencies such as Defence are vigilant and thorough in their planning and procurements, and fair and reasonable in their renegotiations, then the issue of having to terminate for convenience will hopefully seldom arise.

[133] Pederson, above n 23, 85.
[134] Roin, above n 23, 300.