

# Unfair Contract Terms: Termination for Convenience

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## INTRODUCTION

One of law's key challenges is to explain the circumstances in which parties should not be held to their bargains. We have recognised the illusion of certainty promised by freedom of contract principles. On the other hand, there is concern with a principle allowing courts to do whatever an individual judge might think is fair in relation to a particular contractual dispute. This article will consider what the relevant principles should be. It will use a current very topical example as a lens through which these principles should be viewed, that of clauses granting one party to the contract the right to terminate the contract at their convenience, recognising however that much of the content of the article is relevant to the bigger question of the circumstances in which courts should relieve parties from a bargain they have made.

There is an increased trend in business contracts to allow at least one contracting party to terminate the contract upon their convenience, or at will. This is a departure from the traditional approach to termination whereby a contract could only be terminated for cause, leading to the distinction between conditions and warranties, since the courts determined that a contract could validly be terminated for breach only of a term of the contract that fell within the former category. This traditional approach has been largely sidelined by a modern approach allowing one party, not surprisingly often the party that drew up the contract, to terminate at will. Through clauses such as this, the parties have effectively attempted to 'contract out' of the law of contract, or at least that part of contract law that traditionally determined the ability of contracting parties to validly terminate the contract.

Termination for convenience is contemplated by standard form contracts common in industry, such as Australian Standard (AS) 2124 (General Conditions of Contract),<sup>1</sup> AS4000 (General Conditions of Contract),<sup>2</sup> and AS4300 (Design and Construct Contract),<sup>3</sup> all of which allow the principal of the contract to vary the extent of work that the contractor is to do, including terminating the contract at their

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1 (1992) cl 40 deals with variations, including the client reducing the scope of work after the contract has been completed. If this occurs, there is provision for an adjustment to the contract price, including an amount for loss of profit and overhead relating to the works deleted from the contract.

2 (1997) cl 36 deals with variations in a way like cl 40 of AS2124, but providing for an adjustment to the contract price including an amount for loss of profit, but not overhead.

3 (1995) cl 40, in terms virtually identical to cl 40 of AS2124.

convenience.<sup>4</sup>In-house contracts are typically more direct. The author has also seen a range of in-house contracts used by, for example, big players in the mining<sup>5</sup> and construction<sup>6</sup> sector (obviously pivotal to the economy of Western Australia and Australia more generally), that allow the principal (or head contractor) to unilaterally end a contract with a contractor (or sub-contractor). Such clauses also appear in other contractual situations, for example employment contracts, agency/distribution, consulting and franchise agreements, as represented by the cases to which I refer below.

This article considers how, if at all, courts should respond to such clauses, in the context of a business/business contract. Should it enforce such clauses, on the basis of freedom of contract and that the price of the parties' bargain, and other terms, reflect a careful assessment by the parties to it of the relative risks and benefits of it, such that it should not be lightly disturbed by a court? Alternatively, should the court be prepared to intervene, and if so what legal doctrine/s are available and applicable to such clauses? How can demands for certainty and fairness be reconciled in such a contract environment?

Obviously, the question of the extent to which courts should relieve parties from their contractual obligations is a very broad one. As indicated, this article will focus on the particular example of termination for convenience clauses, but obviously the principles discussed are applicable more broadly.

### *Termination for Convenience*

It is understandable that, in the name of flexibility and with economic uncertainty present, businesses ('the client' or 'the principal')<sup>7</sup> might wish to enter into contracts that allow them to re-assess the commitment they have made in the contract to the other contracting party ('the contractor').<sup>8</sup> There is some anecdotal evidence from industry that the use of such clauses has grown further since the so-called global financial crisis in 2008, when funding for many projects became more uncertain. Some industries are affected by the high Australian dollar, the

4 This is subject to the superintendent's approval. The superintendent is typically appointed by the client.

5 This clause is taken from a firm in the mining industry: 'The company will have the right at any time to terminate the services in whole or part for any reason by giving the contractor five business days' notice in writing'.

6 This clause is taken from the standard form contract of a major Australian construction company: 'The contractor may terminate the agreement at any time in its absolute discretion by written notice to the supplier in which case, and provided there have been no defaults by the supplier, the supplier will be entitled to (a) the value of all goods supplied in accordance with the agreement to the date of termination and (b) all reasonable direct costs incurred by the supplier as a result of termination (subject to an obligation of the supplier to mitigate such costs)'.

7 Some contracts use the word 'principal' to refer to this organisation.

8 I will use this phrase for ease of reference; it can include a regular contractor, and a head contractor, with contracts with both the client (principal), and sub-contractors.

carbon tax and the mining tax, and there is ongoing uncertainty regarding the regulatory environment that business will face in the medium to long term.

On the other hand, the contractor may be greatly reliant on a particular contract for their economic survival. They often make investments in capital equipment or machinery, or in human capital, based on an assumption that a contract to which they are a party will be binding on the other party, and will provide some kind of guarantee of work, at least for a finite term, if they meet their obligations under it. They may be surprised to learn, if they read the contract, that it allows the client to escape from the commitment implicit in the contract. If they did read the contract and raised their concerns with the client, it is possible that they might be able to negotiate some changes, dependent on their market position. However, it is more likely that these are provisions of a standard form contract prepared for the client and not surprisingly protective of the client's interests, and it is likely that the contractor will be informed that the conditions, including the termination for convenience clause, are non-negotiable, and that if the contractor is not willing to accept the work on this basis, the client will find another provider that will. This observation is based on the author's twelve years of experience in relation to contracting in the construction and mining industry.

### ***Freedom of Contract***

Of course, a classic freedom of contract position, most dominant in the late 19<sup>th</sup> century and in line with then-dominant theories of legal positivism, would offer little assistance to the contractor in such a situation. The words of Sir George Jessel MR are apposite here:

If there is one thing which more than another public policy requires it is that men of full and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice. Therefore you have this paramount public policy to consider – that you are not lightly to interfere with this freedom of contract.<sup>9</sup>

Some argue that freedom of contract is strongly supported by economic principles, allowing parties to make choices that improve their welfare and promoting efficiency in the allocation of resources.<sup>10</sup> It embraces the economic notion of an individual as a rational, utility maximiser who is best placed to make decisions regarding what is in their best interest. The primary role of contract law is to recognise when a legally binding contract has been made, and to enforce promises.

<sup>9</sup> *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq. 462, 465.

<sup>10</sup> Richard Posner *Economic Analysis of Law* (1992, 4<sup>th</sup> ed) p89-96; Paula Baron 'Shells of Steel and Bodies of Pulp: Commercial Man, Commercial Morality' (1999) 11 *Law in Context* 3, 11; 'certainty in contractual obligations freely assumed is an economically valuable feature of a modern market economy': *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, 351 (Kirby J).

A less well known statement from Wills J is to the same effect and is considered particularly appropriate in the current context:

Any right given by contract may be exercised against the giver by the person to whom it is granted, no matter how wicked, cruel or mean the motive may be which determines the enforcement of the right.<sup>11</sup>

Notions of freedom of contract continue to pervade the Australian case law<sup>12</sup> and academic commentary<sup>13</sup> in this area.

However, this idea (or perhaps ideal) of the sanctity of a contract, conceived in the era of economic liberalism, came to be challenged. Mason and Deane JJ summed up developments succinctly in *Legione v Hateley*:

In the early part of this (20<sup>th</sup>) century overriding importance attached to the concept of freedom of contract and to the need to hold parties to their bargains. These considerations, though still important, should not be allowed to override competing claims based on longstanding heads of justice and equity.<sup>14</sup>

Recently, all members of the High Court dismissed ‘the idea that laissez faire notions of an untrammelled freedom of contract provide a universal legal value’.<sup>15</sup>

As with all economic theories, sometimes unspoken assumptions must always be borne in mind, to test their accuracy and applicability today. Freedom of contract assumed that the parties to the contract were relatively equal in strength of

11 *Allen v Flood* [1898] AC 1, 46.

12 *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516, 575-576 urging great caution in considering the implication of terms into a contract, on the basis of economic freedom of contract; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL and Ors* [2005] VSCA 228, [4] ‘where commercial leviathans are contractually engaged, it is difficult to see that a duty of good faith will arise’; ‘the courts should not be too eager to interfere in the commercial conduct of the parties, especially where all of the parties are wealthy, experienced, commercial entities able to attend to their own interests’: Rogers CJ Comm D in *GSA Group v Siebe PLC* (1993) 30 NSWLR 573, 579; *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45, 75 (Kirby J) and 94 (Callinan J).

13 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, 98 ‘commercial contracts are likely to be the product of extensive negotiation and advice, representing an allocation of risks and interests too nuanced to be reconciled with a general, mandatory obligation of good faith or reasonableness [103]... uncertainty of meaning (referring to reasonableness) is particularly problematic when imported into a commercial contract between parties who may have differing views as to what is reasonable’; Adam Wallwork ‘A Requirement of Good Faith in Construction Contracts?’ (2004) 20 *Building and Construction Law* 257, 265

14 (1983) 152 CLR 406, 448-449.

15 *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30, [5] (French CJ, Gummow, Crennan, Kiefel and Bell JJ).

bargaining power, were able to negotiate a contract that was in their best interests, that parties understood the nature and content of the agreement. In addition, and of particular relevance to termination for convenience clauses, it assumed that the contract price arrived at would reflect a 'true' price given the relative allocation of risks and responsibilities, because the parties understood the scope of the relative risks they were taking.<sup>16</sup>

If these assumptions ever were correct, it has been recognised in more recent times that they no longer reflect the reality of contracting today.<sup>17</sup> There is wide disparity of bargaining power, some involved in contracting have more power than others, often contracts are not the product of negotiation between the parties, but reflect primarily or totally the will of one party, to which the other party has had to submit, and many parties to a contract don't read them or don't understand or don't fully understand the terms of engagement. Equitable principles, and more recently, statutory intervention has sought to reflect some of these realities, though the extent to which both of these do in practice curb, or should curb, freedom of contract is a matter of ongoing debate, as witnessed, for instance, in doubts about the applicability of good faith to contracts governed by Australian law, restrictive interpretation of principles such as unconscionability and unjust enrichment, and (arguably) some timidity in statutory regulation, and timidity in interpretation of that regulation.

In the specific context of termination for convenience clauses, I turn now to consider ways in which courts have, or ways in which courts could, limit or regulate the increased use of such clauses. Implicit in this discussion is my assumption that, at least in some cases, the exercise by one contracting party of a unilateral right to terminate the contract without cause could be (for want of a better term) 'unfair', accepting the subjectivity involved in such a notion. However, recognition of this point by the courts has been relatively rare.

#### (a) *Unfair Contract Terms – Australian Consumer Law*

Section 23 of the *Australian Consumer Law* voids unfair contract terms in standard form contracts. A termination for convenience clause often appears in a standard form contract. In deciding whether it is 'unfair' in terms of s24 and s25, such a clause could meet the requirements of s24.<sup>18</sup> It seems directly

16 Liam Brown 'The Impact of Section 51AC of the Trade Practices Act 1974 (Cth) on Commercial Certainty' (2004) 28 *Melbourne University Law Review* 589, 593.

17 Eileen Webb 'Considering Unfairness in Retail Leases – A Bridge Too Far or Justifiable Extension?' (2010) 19 *Australian Property Law Journal* 58, 59 and 68-69.

18 These consider whether the clause causes significant imbalance in the parties' contractual obligations, whether it was necessary to protect the parties' legitimate interests, and the extent of detriment caused to the other party. The same conclusion is reached by Amanda McBratney and Myles McGregor-Lowndes 'Fair Government Contracts for Community Service Provision: Time to Curb Unfettered Executive Freedom?' (2012) 20 *Australian Journal of Administrative Law* 19, 30.

within the contemplation of s25(1)(b) which gives as an example of an unfair term one which permits one party but not the other to terminate the contract. This is typically exactly what a termination for convenience clause does. However, the argument is precluded because s23(3) limits the application of the unfair contract terms provisions of the *Australian Consumer Law* to ‘consumer’ contracts. As finally passed,<sup>19</sup> the provisions do not apply to business/business contracts. As a result, this remedy will not be considered further.<sup>20</sup>

## (b) *Good Faith*

The aim of any mature system of contract law must be to promote the observance of good faith and fair dealing in the conclusion and performance of contracts...<sup>21</sup> (people) must be able to assume that those with whom they deal in the general intercourse of society will act in good faith.<sup>22</sup>

The acceptance of this doctrine as part of Australian law continues to await High Court approval.<sup>23</sup> However, in a series of decisions, courts at the state appellate level have accepted the applicability of principles of good faith in relation to contracts to which Australian law applies.<sup>24</sup> Good faith has been recognised

19 Eileen Webb notes that originally the provisions were to apply to business/business contracts, and there was recognition that whether the contract was business/consumer or business/business, there was potential for both to include unfair terms, both to involve lack of negotiation etc. However, lobbying to remove business/business contracts from the purview of the unfair contract terms provisions succeeded: ‘Considering Unfairness in Retail Leases – A Bridge Too Far or Justifiable Extension?’ (2010) 19 *Australian Property Law Journal* 58,69; Aviva Freilich ‘A Radical Solution to Problems With the Statutory Definition of Consumer: All Transactions Are Consumer Transactions’ (2006) 33 *University of Western Australia Law Review* 108; and see Meredith Miller ‘Contract Law, Party Sophistication and the New Formalism’ (2010) 75 *Missouri Law Review* 493, rejecting the simplistic distinction between sophisticated and unsophisticated contracting parties that arguably underpins the definition of consumer, and at least traditionally, the reach of the common law notion of unconscionability.

20 For the record, I believe that such provisions should be extended to apply to business/business contracts.

21 Lord Steyn ‘The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy’ (1991) 6 *Denning Law Journal* 131, 131; Lord Atkin ‘business men habitually ... trust to luck or the good faith of the opposite party’: *Phoenix Insurance Co v DeMonchy* (1929) 141 LTR 439, 445 (House of Lords).

22 Roscoe Pound *An Introduction to the Philosophy of Law* (1922) p188.

23 On occasion, the High Court has appeared displeased by attempts by lower courts to develop the law in somewhat novel ways: *Farah Constructions Pty Limited v Say-Dee Pty Limited* (2007) 230 CLR 89, 149 (Gleeson CJ Gummow Callinan Heydon and Crennan JJ); however the High Court has had opportunities, and declined, to cast judgment on the doctrine of good faith one way or another: *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45, on the basis that it was an inappropriate case in which to consider it (63 (Gleeson CJ Gaudron McHugh Gummow and Hayne JJ), 75-76 (Kirby J) and 94 (Callinan J)). An opportunity may arise shortly, with the The High Court declined special leave to appeal the decision in *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd* [2012] NSWCA 184, a decision based partly on good faith.

24 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR; *Burger*

in international legal instruments as being fundamental to contracting,<sup>25</sup> and is of ancient vintage, being traceable to Roman law.<sup>26</sup> To the extent that we see contracts in economic terms, there are sound economic reasons for its recognition. It has been recognised that recognition of such a doctrine does or would reduce the economic costs of contracting, reducing costs associated with gathering information on an organisation's prospective contracting partners, negotiating and drafting contracts, and reducing future risk.<sup>27</sup> There is debate regarding whether the requirement of good faith is to be implied as a term at law, in fact, or instead is an underlying contractual principle which requires no implication.<sup>28</sup>

Obviously, to a large extent commercial law was extensively based on the practice of merchants, this practice being evident in England since at least the 17<sup>th</sup> century.<sup>29</sup> In this light, there is an interesting literature that traditional rules of contract law, emphasising freedom of contract over notions like good faith, serve to perpetuate a kind of adversarial, non-trusting environment that is at odds with most business contracting.<sup>30</sup>

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*King Corporation v Hungry Jack's Pty Limited* [2001] NSWCA 187; *Alcatel Australia Ltd v Scarcella and Ors* [1998] NSWSC 483; *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177; *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd* [2012] NSWCA 184; *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* [2010] WASCA 222; less strongly *Eso Australia Resources Pty Ltd v Southern Pacific Petroleum NL and Ors* [2005] VSCA 228.

- 25 *Uniform Commercial Code* (US)(section 1-203), *Restatement (Second) of the Law of Contracts* (US)(s205), *United Nations Convention on Contracts for the International Sale of Goods* (Article 7(1)); Article 242 of the BGB (Germany), Article 1134(3) of the *French Civil Code*, Article 1.7 of the *UNIDROIT Principles of International Commercial Contracts*. Lord Steyn says the international context 'demonstrate(s) that in the hard school of litigation and international commercial arbitration, (good faith has been shown to be a) perfectly workable and sensible technique for the imposition of legal duties in many legal systems': 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?' (1991) 6 *Denning Law Journal* 131, 140.
- 26 *Justinian's Digest*, II XIV 27.3: SP Scott *The Civil Law, Translations of Roman Legal Texts* (1932); Suzanne Corcoran 'Good Faith as a Principle of Interpretation: What is the Positive Content of Good Faith?' (2012) 26 *Australian Bar Review* 1, 3-4.
- 27 Steven Burton 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1981) 94 *Harvard Law Review* 369, 393.
- 28 Elisabeth Peden 'Incorporating Terms of Good Faith in Contract Law in Australia' (2001) 23 *Sydney Law Review* 222, 224-231; Bill Dixon 'Good Faith in Contractual Performance and Enforcement – Australian Doctrinal Hurdles' (2011) 39 *Australian Business Law Review* 227.
- 29 Patrick Devlin 'The Relation Between Commercial Law and Commercial Practice' (1951) 14 *Modern Law Review* 249, 250.
- 30 Girard 'Good Faith in Contract Performance: Principle or Placebo?' (1983) 5 *Supreme Court Law Review* 309, 326.



Jurists such as Macaulay<sup>31</sup> and Macneil<sup>32</sup> engaged in important empirical work on the attitudes and experiences of contracting parties. Broadly, they found a high degree of trust and commitment to long-term contractual relationships, including acceptance of norms that commitments are to be honoured in almost all situations, and that reputation and long-term contractual relationships are all-important.<sup>33</sup> Freedom of contract, to the extent it assumes individuals are rational, utility maximisers fails to capture this reality.

These findings would be consistent with the application of good faith principles in contracting.<sup>34</sup> It is considered important that law, including commercial law, be harmonious with, and not antagonistic towards, the nature of the relationships which it purports to regulate.<sup>35</sup> If business people generally act with an attitude of good faith towards others with whom they contract, and expecting good faith in contract performance is a reasonable expectation that contracting parties have,<sup>36</sup> it does not seem so problematic to apply notions of good faith to such an

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31 Stewart Macaulay 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28(1) *American Sociological Review* 55; Alex Johnson 'Correctly Interpreting Long-Term Leases Pursuant to Modern Contract Law: Toward a Theory of Relational Leases' (1988) 74 *Virginia Law Review* 752; Matthew Lees 'Contract, Conscience, Communitarian Conspiracies and Confucius: Normativism Through the Looking Glass of Relational Contract Theory' (2001) 25 *Melbourne University Law Review* 82.

32 Ian Macneil 'Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law' (1978) 72 *Northwestern University Law Review* 854; 'Relational Contract Theory: Challenges and Queries' (2000) 94(3) *Northwestern University Law Review* 877; Irish Bohnet, Bruno Frey and Steffen Huck 'More Order With Less Law: On Contract Enforcement, Trust and Crowding' (2001) 95(1) *American Political Science Review* 131; Scott talks of the 'incongruence of simple rules and complex relationships': Robert Scott 'The Death of Contract Law' (2004) 54 *University of Toronto Law Journal* 369, 372.

33 'many people behave in a reciprocal manner that deviates from purely self-interested behaviour': Robert Scott 'The Death of Contract Law' (2004) 54 *University of Toronto Law Journal* 369, 383.

34 Stewart Macaulay 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66 *Modern Law Review* 44, 44: 'if we want our courts to carry out the expectations of the parties to contracts, both those that they express in writing and those that are left unrecorded or even unspoken, we must accept a contract law that rests on standards rather than on clear, quantitative rules. Contract law will then talk of good faith, duties of cooperation or within limits set by commercial reasonableness'.

35 'relational contract law should generally track the relational behaviour and norms found in the relations to which it applies': Ian Macneil 'Relational Contract Theory: Challenges and Queries' (2000) 94(3) *Northwestern University Law Review* 877, 903; Devlin referred to the 'constant danger' that the ideas of lawyers and of business people are asynchronous: Patrick Devlin 'The Relation Between Commercial Law and Commercial Practice' (1951) 14 *Modern Law Review* 249, 263.

36 The High Court has accepted the principle that courts should apply a business-like approach to the interpretation of contracts: *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151, 160 and 174; reference to the need for contract law to reflect parties' reasonable expectations appears in *First Energy (UK) Ltd v Hungarian Investment Bank Ltd* [1993] 2 Lloyd's Rep 194; Steyn LJ 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *Law Quarterly Review* 433.



environment,<sup>37</sup> despite what some judges have found.

How does this apply in the current context? As Warren CJ noted, the exercise of a termination for convenience clause is often seen as an example of ‘bad faith’ conduct. Duke makes the same point. After pointing out relational aspects of contracting and that the written contract reflects only a rough indication of how the parties intend their relationship to work, they add:

In order to ensure parties honour their contractual relationships, courts must acknowledge realities such as those discussed above rather than permitting parties the unqualified right to enforce or terminate an agreement by reference to terms that are almost certainly going to be incomplete as well as out of sync with the expectations the parties have about the nature of their evolving exchange relationship and the co-operative spirit underpinning that relationship. When these realities are taken into account, it becomes clear that rather than overriding the intentions of the parties, the implied duty of good faith can be seen as effecting the intentions and reasonable expectations of the parties from their entire exchange relationship.<sup>38</sup>

A precise definition of good faith is notoriously elusive. It might be better to identify specific strands of the concept, as Sir Anthony Mason did.<sup>39</sup> Some of these strands are relevant to the current context; some are not. For instance, some argue that good faith means honesty.<sup>40</sup> I will not dwell on this strand here, because I am not suggesting that a party exercising a termination for convenience clause is acting dishonestly. Further, some argue that good faith means that one party will not prevent the other party to the contract from enjoying the benefit of the

37 Bathurst CJ (with whom Ipp JA and Macfarlan JA agreed) concluded that good faith ‘has been an underlying concept in the law merchant for centuries’: *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177, [58]

38 Arlen Duke ‘A Universal Duty of Good Faith: An Economic Perspective’ (2007) 33 *Monash University Law Review* 182, 196-197.

39 Of the four strands to which I refer, Mason identified the first, second and fourth in ‘Contract, Good Faith and Equitable Standards in Fair Dealing’ (2000) 116 *Law Quarterly Review* 66, 69.

40 *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177 the Court discussed good faith in terms of honesty and ‘fidelity to the bargain’ [70] (Allsop P, with whom Ipp JA and Macfarlan JA agreed); *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* [2010] WASCA 222; *Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd* [2012] VSC 99, [422]; Elisabeth Peden ‘When Common Law Trumps Equity: The Rise of Good Faith and Reasonableness and the Demise of Unconscionability’ (2005) 21 *Journal of Contract Law* 226, 235. Article 1-201 of the Uniform Commercial Code defines good faith to mean honesty in fact in the conduct or transaction concerned, although see Article 2 (below). Others suggest that while not wrong to say that good faith includes honesty, it is wrong to *confine* good faith to honesty: Robert Summers ‘Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code’ (1968) 54 *Virginia Law Review* 195, 204; Suzanne Corcoran ‘Good Faith as a Principle of Interpretation: What is the Positive Content of Good Faith?’ (2012) 36 *Australian Bar Review* 1, 3.

contract by making it difficult or impossible for the other to meet their obligations under the contract.<sup>41</sup> Similarly, I do not suggest that this strand of good faith is particularly relevant to the exercise of a termination for convenience clause.

A third strand would prevent a power in a contract from being used for a purpose beyond the understanding of the parties at the time at which the contract was executed.<sup>42</sup> Burton uses this concept in exploring what he considers the proper limits of the good faith doctrine. He would not allow the use of discretion in provisions of the contract, including for relevant purposes the termination for convenience option, where to do so is an attempt by the party exercising it to 'recapture foregone opportunities'. On the other hand, a party acts in bad faith by exploiting an option under the contract for reasons other than for which it was given to them. There are several difficulties in applying this line of cases, and this academic theory, to termination for convenience clauses. Firstly, the reason or reasons why a termination for convenience clause has been included in the contract are usually not expressed – indeed, part of their appeal is their open-ended nature. There are obvious difficulties in going behind the express terms of the contract to determine what motivated the parties' inclusion of such a clause in their contract. Further, Burton would not allow the use of a termination right where to do so would be an attempt to recapture foregone opportunities. In a sense, arguably every termination for convenience clause would meet this description. When two parties engage contractually, they have made a choice among a host of alternative options, presumably deciding this contract is best for them. By contracting with one party, they forego the opportunity to contract for the same product or service from another. This might mean that Burton would not allow one party to use a termination for convenience right.<sup>43</sup>

41 *McKay v Dick* (1881) 6 App Cas 251, 263.

42 *Godfrey Constructions Pty Ltd v Kanagra Park Pty Ltd* (1972) 128 CLR 529, 551-552 (Stephen J); *Burger King Corporation v Hungry Jack's Pty Limited* [2001] NSWCA 187, [185]; *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349, 368. This kind of conduct was referred to by judges in *Legione v Hately* as providing grounds of (equitable) relief, though they did not use the language of good faith to describe equity's intervention in such cases: (1983) 152 CLR 406, 449 (Mason and Deane JJ); *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL and Ors* [2005] VSCA 228, [25] 'it may be appropriate to import .. an obligation (of good faith) to protect a vulnerable party from exploitive (sic) conduct which subverts the original purpose for which the contract was made' (Buchanan JA, with whom Osborn AJA agreed); Steven Burton 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1981) 94 *Harvard Law Review* 369, 386.

43 Steven Burton 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1981) 94 *Harvard Law Review* 369. Burton applauds the decision in *Fortune v National Cash Register Co* 364 N.E. 2d 1251 (1977), where a court read in to an employment contract expressly conferring the employer's right to terminate at will a requirement of good faith. Alternatively, it might mean that termination for convenience clauses can only be used, for example, where the basis underlying the contract has changed. For instance, in the United States such clauses began to be used in wartime because the United States government was not sure of what its future commitments might be, so needed flexibility in service delivery. In such a context, it might be okay for the client to use such a clause because the war has in fact ended, but not to use it when the war is still going, but the government has found a cheaper contractor to do the required work.

The most applicable strand of good faith doctrine to the current situation, and the most contentious of the strands, is the idea that contractual remedies must be exercised in a way that is 'reasonable'.<sup>44</sup> According to Farnsworth, good faith in its original conception, back in Roman times, applied to performance of contractual obligations, and in that context good faith encompassed an aspect of reasonableness.<sup>45</sup> He writes that it was only later that the concept came to be applied in the context of what he calls 'good faith purchase', and that was the context in which concepts of honesty came to be associated with good faith, or to be more precise, that the suggestion appeared that good faith was *limited* to honesty. However, its original meaning encompassed notions of reasonableness.<sup>46</sup> He suggested that the reasonableness standard should apply to all contexts in which good faith is raised.<sup>47</sup> Given the close historical and ongoing links between the practice of merchants and commercial law as alluded to above, a requirement of 'reasonableness' in applying notions of good faith appears workable, given that the content of this obligation will reflect commercial practice and the expectations of individuals in that field.<sup>48</sup>

44 Article 2- 103(1)(b) defines good faith as honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade. The Comment to c1205 of the *Restatement of Contracts (Second)* refers expressly to reasonableness in explaining the duty of good faith. Many of the United States cases refer to concepts of reasonableness in their good faith discussion. See for example *Questar Builders Inc v CB Flooring LLC* 978 A 2d 651, 672 (2009), *Krygoski v Construction Company Inc v United States* 94 F. 3d 1537, 1544 (1996), *T and M Distributors Inc v United States* 185 F 3d 1279, 1284 (1999), *R A Weaver and Associates Inc v Asphalt Construction Inc* 587 F 2d 1315, 1322 (1978); *Carrico v Delp* 141 Ill App 3d 684 (1986); reasonableness was referred to by Sir Anthony Mason in his description of good faith as embracing three principles: 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66, 69; . The inclusion of concepts of reasonableness in relation to good faith doctrine has been trenchantly criticised: John Carter and Elisabeth Peden 'Good Faith in Australian Contract Law' (2003) 19 *Australian Journal of Contract Law* 155 who would confine good faith to honesty, which would include the concept of reasonableness only to the very limited extent of whether no reasonable person could regard the contracting party's conduct as reasonable in the circumstances (borrowed from administrative law); Elisabeth Peden 'When Common Law Trumps Equity: The Rise of Good Faith and Reasonableness and the Demise of Unconscionability' (2005) 21 *Journal of Contract Law* 226, Elisabeth Peden 'The Meaning of Contractual Good Faith' (2002) 22 *Australian Bar Review* 235; cf Lord Steyn 'good faith has a subjective requirement: the threshold requirement is that the party must act honestly ... But good faith additionally sets an objective standard, viz the observance of reasonable commercial standards of fair dealing in the conclusion and performance of the transaction concerned: 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *Law Quarterly Review* 433, 438.

45 This position is supported by Roscoe Pound: 'the parties were bound to perform what could be required fairly and reasonably under the circumstances of the case': *Jurisprudence Volume 1* (1959) p414.

46 Allan Farnsworth 'Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code' (1963) 30 *University of Chicago Law Review* 666, 668-670.

47 678.

48 'The usages and practices of dealings in those disparate fields will be prime evidence of what is reasonable': Steyn LJ 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *Law Quarterly Review* 433, 434.

This idea long pre-dated what is generally considered to be the leading case on the good faith doctrine in Australia, *Renard Constructions*, about which more is said below. Recognition in Roman law has been noted. If we confine ourselves to the 20<sup>th</sup> century in Australia, for instance, in the 1910 case of *Gardiner v Orchard*, Isaacs J stated that the ability of a contracting party to exercise a right to terminate the contract was limited by the requirements of good faith and reasonableness.<sup>49</sup> A suggestion that a contractual power might need to be exercised in a reasonable manner also appears in a unanimous High Court decision in 1953.<sup>50</sup> In 1972 members of the High Court in two different cases decided that the vendor's expressed right of rescission in the contract had to be exercised in a reasonable manner.<sup>51</sup> There is also express reference in these cases to good faith as either an alternative doctrine or as encompassing<sup>52</sup> the requirement of reasonableness.<sup>53</sup> In the leading modern Australian case on good faith in contracting, *Renard Constructions*, the contract allowed the principal to terminate the contract if the party in default had not responded adequately to a notice to remedy breach (show cause notice). The court was concerned that the principal's power could be used in relation to trivial breaches of the contract:

For the principal, in such circumstances, to be able then to exclude the contractor from the site and/or cancel the contract would be, in my opinion, to make the contract as a matter of business quite unworkable ...

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- 49 (1910) 10 CLR 722, 739-740 (citing *Woolcott v Pegg* (1889) 15 App Cas 42).
  - 50 In *Carr v J A Berriman Pty Ltd* (1953) 89 CLR 327, Fullagar J (with whom Dixon CJ Williams Webb and Kitto JJ expressed agreement), in discussing the contractual power of an architect to take work out of the hands of the original contractor, and give it to someone else, stated: 'a power in the architect to hand over at will any part of the contract to another contractor would be a most unreasonable power, which very clear words would be required to confer'.
  - 51 *Godfrey Constructions Pty Ltd v Kanagra Park Pty Ltd* (1972) 128 CLR 529, 546 (Walsh J), 547 (Gibbs J) and 552 (Stephen J); *Pierce Bell Sales Pty Ltd v Frazer* (1972) 130 CLR 575, 589 (Barwick CJ, 'I am not convinced that it would be unreasonable ... on the part of the respondents to exercise their right of rescission, with whom McTiernan J agreed), 591 (Gibbs J ('it remains to consider whether the action of the respondents, in seeking to rescind, can be said to have been ... unreasonable')). In neither case did the contract expressly state that the power of termination could only be used 'reasonably'.
  - 52 In *Burger King*, the New South Wales Court of Appeal noted the Australian cases had made no substantial distinction between an implied term of reasonableness, and an implied term of good faith: [169]. In *Renard*, however, Priestley J stated that the two concepts had much in common (263). In *Vodafone Pacific Ltd v Mobile Innovations Ltd* (2004) NSWCA 15, Giles JA referred to an implied term that Vodafone would 'act in good faith and reasonably' (198). Others have claimed the concepts are materially different, it being possible to act in good faith but unreasonably, or in other words that the requirement of reasonableness imposes a more exacting standard (*Minster Trust Ltd v Traps Tractor Ltd* [1954] 1 WLR 963, 973; Jane Stapleton 'Good Faith in Private Law' (1999) 52 *Current Legal Problems* 1).
  - 53 *Godfrey Constructions Pty Ltd v Kanagra Park Pty Ltd* (1972) 128 CLR 529, 552 (Stephen J); *Pierce Bell Sales Pty Ltd v Frazer* (1972) 130 CLR 575, 590 (Gibbs J, 'there was no evidence that the respondents, in exercising their right of rescission, were acting in bad faith'). In neither case did the contract expressly state that the power of termination could only be used in good faith.

no contractor in his senses would enter into such a contract under which such a thing could happen. The reasonable contractor, the reasonable principal and the reasonable onlooker would all assume that such a result could not come about except with good reason. The overriding purpose of the contract from the contractor's and the principal's point of view is to have the contract work completed by the contractor in accordance with the contract, in return for payment by the principal in accordance with the contract. The insertion of the (show cause clause) not to the restraint of reasonable use by the principal is quite inconsistent with all the main contractual promises by each party to the contract with the other. The contract can in my opinion only be effective as a workable business document under which the promises of each party to the other may be fulfilled, if the subclause is read in a way I have indicated, that is as subject to a requirement of reasonableness.<sup>54</sup>

Obviously, if these judges were concerned that the termination power could be enlivened after a trivial breach of contract, they would be even more concerned that a termination power could be used in the absence of any breach at all. They would presumably be prepared to condition the use of such power the requirement of 'reasonableness'.

Similar sentiments appear in the New South Wales Court of Appeal decision in *Burger King Corporation v Hungry Jack's Pty Limited*,<sup>55</sup> involving, among other things, a power of the former to terminate contracts with the latter. The Court accepted that the exercise of such a power was subject to requirements of good faith and/or reasonableness. It noted the case for implication of such terms was stronger in the context of standard form contracts, and stronger when contracts contained a general power of termination.<sup>56</sup> These comments are directly relevant to cases of termination for convenience clauses which often appear in standard form contracts, as indicated. The Court again noted here that unless the power to terminate was conditioned by a requirement of reasonableness, the party with that power could for the slightest of breaches terminate very valuable contractual rights of the other party.<sup>57</sup> Again, if the court is concerned the power of termination could be used for trivial breaches, it must be concerned the power of termination

54 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 233, 258 (Priestley JA, with whom Handley JA agreed (279)); see also *Hughes Aircraft Systems International v Airservices Australia* [1997] FCA 558, p39-40, *GEC Marconi Systems Pty Limited v BHP Information Technology Pty Limited* [2003] FCA 50, [918]-[920].

55 [2001] NSWCA 187 (Sheller JA, Beazley JA, Stein JA, joint reasons); *Alcatel Australia Pty Ltd v Scarcella* (1998) 44 NSWLR 349; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL and Ors* [2005] VSCA 228, per Warren CJ [2] 'a duty of good faith is no more than a duty to act reasonably in performance and enforcement', Buchanan JA [28] (with whom Osborn AJA agreed) applied the test of reasonableness in assessing the validity of a provision.

56 [163]; see also *Garry Rogers Motors Aust Pty Limited v Subaru (Aust) Pty Ltd* [1999] FCA 903.

57 [183]

could be used where there is no breach at all. The requirement of reasonableness in the exercise of termination rights has also been applied in more recent cases.<sup>58</sup> Chief Justice of the Supreme Court of Victoria Warren has noted that use of a termination for convenience clause is often characterised as being an act of bad faith.<sup>59</sup> On the other hand, some courts have decided that an express termination for convenience clause leaves no room for the application of implied notions of good faith, because it would be inconsistent with the express contractual right.<sup>60</sup> Carter and Stewart were also dismissive of the application of good faith, at least to the extent that it encompasses reasonableness, in this context:

If a contract says that a party has a discretion to do something, such as to terminate a contract, the conception of good faith as an overlay of reasonableness means that the discretion is qualified, so that, for example, a party can only exercise a right of termination if it is objectively reasonable for it to do so. In our view this is contrary to the principles

58 *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd* [2012] NSWCA 184, [145], [167] (Bathurst CJ, Macfarlan JA and Meagher JA agreeing)(special leave to appeal to the High Court granted)(existence of good faith obligation conceded); *Robert McGill Freier and Anor v Australian Postal Corporation* (No 2)[2012] NSWSC 61, [23](court considered whether Australia Post's offer of compensation following exercise of a termination for convenience option was 'reasonable'); *John Tumminello v TAB Limited* [2011] NSWSC 1639, [55]; in *Kellogg Brown and Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200 Hansen J found there was a serious question to be tried regarding the applicability of notions of good faith to the exercise of a termination for convenience clause power, and whether it breached good faith requirements, [61]. In *BAE Systems Australia Ltd v Cubic Defence New Zealand Ltd* [2011] FCA 1434, Besanko J denied that the client's exercise of a termination for convenience right was subject to a duty of co-operation, which is a strand of good faith: [72]. The judge applied the test of reasonableness and good faith to the use of a termination for convenience clause in an employment contract in *Moloney v Rural Council of Murray Bridge* [2012] SADC 126, [302], [305], though the defendant there conceded the applicability of notions of good faith to such exercise; the court in *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 implied a doctrine of reasonableness to the exercise of an unqualified, but criterion-based, right of the other party to determine a contractual bonus payment; good faith and reasonableness were accepted and applied in *Alstom Ltd v Yokogawa Australia Pty Ltd and Anor* (No 7)[2012] SASC 49, [595]-[598](Bleby J). I have referred earlier in the article to United States decisions which also refer to reasonableness in the context of consideration whether exercise of termination for convenience rights was in good faith, the most recent example being *Questar Builders Inc v CB Flooring LLC* 978 A 2d 651 (Md 2009).

59 'Good Faith: Where Are We At?' (2010) 34 *Melbourne University Law Review* 344, 356.

60 *Trans Petroleum (Australia) Pty Ltd v White Gum Petroleum Pty Ltd* [2012] WASCA 165, [155]: 'implication of (a duty of good faith) would be inconsistent with the terms of the bargain agreed upon by the parties' (containing a termination for convenience clause)(Buss JA, with whom Pullin JA and Murphy JA agreed); Foster J in *Sundararajah v Teachers Federation Health Limited* [2011] FCA 1031, [64] to like effect; *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 190, [33](Ipp JA, Mason P and Giles JA agreeing), *Beerens v Bluescope Distribution Pty Ltd* [2012] VSCA 209, [167](Tate JA, with whom Redlich JA agreed); *Rumsfeld v Freedom New York* 329 F 3d 1320, 1331 (2003). Edelman J in *Hampton v BHP Billiton Minerals Pty Ltd* (No2)[2012] WASC 285 recently stated that contractual powers that can be exercised at the sole discretion of one party may exclude the implication of a term of reasonableness, before acknowledging that a requirement of reasonableness could mitigate a broad power of termination: [263]-[264].



of commercial construction because implication of a requirement of reasonableness may second guess the bargain.<sup>61</sup>

This currently contentious issue,<sup>62</sup> whether the good faith requirement is confined to (subjective) honesty, or whether it includes (objective) reasonableness,<sup>63</sup> matters greatly in the current context. It would be virtually impossible to argue that the exercise of a termination for convenience clause right was dishonest. It is much easier to argue that the exercise of such a clause was, in the circumstances, unreasonable. As a result, it is hoped that the High Court appeal from the decision of one of these cases will resolve this conflict, providing the High Court with the perfect opportunity to clarify the boundaries of the good faith doctrine.

The author favours the inclusion within the principle of good faith the concept of reasonableness. Sir Anthony Mason favoured this view. It has clear historical support in terms of the original conception of good faith. The High Court itself has read in requirements of reasonableness in relation to apparently open-ended termination or forfeiture rights. It reflects the expectations of commercial business people, and is consistent with the relational view of contracting, as opposed to the adversarial, discrete model traditionally favoured by the law of contract. Concerns that this introduces unnecessary uncertainty into contract law are misconceived. The law of contract, and the law generally, already refers to concepts of 'reasonableness' in many different contexts. This principle has proven itself to be quite workable in practice.

### ***An Analogy with Good Faith in Insurance Contracts?***

The role of Lord Mansfield in the development of the common law of merchant, as reflective of actual business practice, needs no elaboration. Lord Mansfield himself noted in 1766 that good faith was 'the governing principle ... to all contracts and dealings'.<sup>64</sup> The law of the United Kingdom did not in fact generally develop in this direction, preferring instead (at least in the 19<sup>th</sup> century, and according to the common law rather than equity) freedom of contract. In the 1990s, the House of Lords continued to reject the notion of good faith as applied

61 John Carter and Andrew Stewart 'Interpretation, Good Faith and the True Meaning of Contracts: The Royal Botanic Decision' (2002) 18 *Journal of Contract Law* 182, 192.

62 The New South Wales Court of Appeal appears divided: in *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177 in favour of honesty and fidelity to the contract (Allsop P, Ipp JA and Macfarlan JA); in *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd* [2012] NSWCA 184 in favour of honesty, co-operation and reasonableness (Bathurst CJ, Macfarlan JA and Meagher JA). It is hoped the High Court appeal in *Cordon Investments* will clarify this conflict at state appellate level.

63 As indicated, there are other formulations of precisely what good faith means, but a decision as between these two understandings is critical in the current context.

64 *Carter v Boehm* (1766) 3 Burr. 1905, 1909 (97 ER 1162, 1164); see also Lord Kenyon 'in contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith' (*Mellish v Motteux* (1792) Peake 156, 157 (170 ER 113, 114)).



to contracts as being ‘unworkable’.<sup>65</sup>

There was one area, however, where the courts continued to apply Lord Mansfield’s notion of good faith regarding contracting, that being insurance contracts. Every law student learns that contracts of insurance are contracts of the utmost good faith, perhaps without being asked to consider why it is that such contracts are said to be governed by the doctrine, but not others. One justification that is often given is that some matters with respect to the risk the subject of the insurance policy are only known to, or knowable by, the insured. The insurer cannot reasonably be expected to investigate such matters. The economic logic is that if the insurer cannot properly assess the risk, they cannot properly price the insurance contract.<sup>66</sup> The law works economic justice by imposing a duty of disclosure on the insured as part of a good faith obligation, since it is only through disclosure of such relevant information that the parties can reach true agreement, and at a ‘fair’ price, since information asymmetries have been removed.

If this argument is accepted as a justification for imposing good faith in the context of insurance contracts, there is surely a sound argument for imposing good faith in the exercise of a termination for convenience clause. The existence of a such a clause also creates ‘contract pricing’ difficulties. Remember in the context of freedom of contract, we noted that the classical economic model of contracting stated that parties were the best judges of the trade-off involved in different clauses. They were best able to decide for themselves whether the contract made them better off, after assessing the risks and rewards contained in the contract. This was why the court should not intervene.

However, this argument is very difficult to apply in the context of termination for convenience clauses. The contractor has no control over whether the clause will be exercised or not; this occurs independently of the contractor being at fault in any way. The contractor cannot know the likelihood that the client will exercise this option. This makes it impossible to do as the traditional freedom of contract doctrine would have us do, which is to price in the risk.<sup>67</sup> In economic terms,

65 *Walford v Miles* [1992] 2 AC at 128,138: ‘the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations ... a duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent’; cf *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177, where good faith obligations were applied in a negotiation setting.

66 Sir Anthony Mason notes as another instance of good faith doctrine that the vendor of property is also obliged to disclose details of the property to be sold to a purchaser, where the purchaser has no means of discovering such details, citing *Carlisle v Salt* [1906] 1 Ch 355: ‘Contract, Good Faith and Equitable Standards in Fair Dealing’ (2000) 116 *Law Quarterly Review* 66, 73.

67 Smith says that the law is justified intervening on the basis of ‘substantive unfairness’ where the actual contract price deviates significantly, both in absolute and relative terms, from the ‘normal’ price: Stephen Smith ‘In Defence of Substantive Fairness’ (1996) 112 *Law Quarterly Review* 138, 154. If one of the parties is unable to price the contract properly because they are unable to assess the risk that the other party will exercise the

it is a market failure. So even if the general principle of good faith is not held applicable to all contracts, it is argued that it should be applicable to the exercise of a termination for convenience clause because, just as with insurance contracts where the doctrine is applied, one party is at an informational disadvantage through no fault of their own and which they cannot reasonably rectify. This means they are not able to accurately price risk that the hands-off, freedom of contract principles assume, so that rationale for non-imposition of good faith is not applicable.

(c) ***Unconscionability – Australian Consumer Law and the Common Law***

Section 20 of the *Australian Consumer Law* prohibits unconscionable conduct within the meaning of the common law.<sup>68</sup> The High Court's interpretation of the common law principle of unconscionable conduct has been relatively narrow, requiring proof that the claimant was at a special disadvantage, which was known to the stronger party, and which the strong party exploited to obtain a benefit.<sup>69</sup> The Court has emphasised that the disadvantage must be special, seriously affecting the ability of the innocent party to judge what is in their best interests,<sup>70</sup> or resulting in their will being overborne.<sup>71</sup> As a result, inequality of bargaining power will not be sufficient.<sup>72</sup>

Further, traditionally courts have been reluctant, in applying common law unconscionability, and thus flowing through to previous s51AA of the *Trade Practices Act 1974* (Cth) and now s20 of the *Australian Consumer Law*, to consider substantive unconscionability, as opposed to procedural unconscionability, as falling within the doctrine.<sup>73</sup> In other words, the court has been prepared to consider the steps leading up to the making of the contract to ensure fairness in that process, but not the fairness of the clauses in the contract themselves.

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termination for convenience option, this could lead to the kind of deviation to which Smith refers.

68 This was previously s51AC of the *Trade Practices Act 1974* (Cth), and the provisions are substantially identical.

69 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; *Blomley v Ryan* (1956) 99 CLR 362. This has been criticised as unduly narrow, excluding cases where the weaker party had a lack of fair opportunity: Rick Bigwood 'Curbing Unconscionability: *Berbatis* in the High Court of Australia' (2004) 28 *Melbourne University Law Review* 203, 222-224; Bryan Horrigan 'The Expansion of Fairness-Based Business Regulation – Unconscionability, Good Faith and the Law's Informed Conscience' (2004) 32 *Australian Business Law Review* 159, 176.

70 *ACCC v Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, 77 (Gummow and Hayne JJ); .

71 *ACCC v Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, 108 (Callinan J). Rick Bigwood 'Curbing Unconscionability: *Berbatis* in the High Court of Australia' (2004) 28 *Melbourne University Law Review* 203.

72 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447, 462 (Mason J); *ACCC v Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, 64 (Gleeson CJ).

73 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447, 459 (Gibbs CJ), 466 (Mason J) and 474 (Deane J); *Hurley v McDonald's Australia Ltd* (2000) ATPR 41-741 .

These things combined lead to the conclusion that s20 would not be of much use to a party complaining about the unfair use of a termination for convenience clause. It would be virtually impossible for a commercial party to argue that they were under the kind of ‘special disadvantage’ contemplated in cases like *Amadio*. Rogers J noted this in a case involving two large international companies:

The emphasis on the wealth and standing of the defendants and their ready access to the best of advice is to displace the operation of the concepts of unconscionable conduct which underlie decisions such as ... *Amadio* ... For a successful and wealthy international conglomerate to appeal to the safeguards the law provides for the elderly, the illiterate and the financially oppressed is to move into a totally inappropriate field of discourse.<sup>74</sup>

In the specific context of forfeiture of contractual interests, with obvious relevance to the current context of termination for convenience clauses, the High Court has recognised that exercise of legal rights in a contract may amount to unconscionable conduct.<sup>75</sup> Relief was in fact granted in that case against forfeiture of a contractual interest, even when the party seeking relief was in fundamental breach of the contract.<sup>76</sup> The argument might be that in cases when the party seeking relief had not in fact breached the contract, a claim for unconscionable conduct on the ‘terminator’s’ part might be stronger.

Even if this obstacle could be overcome, Australian courts have traditionally not been prepared to consider whether particular clauses in the contract work unfairness in relation to ‘unconscionability’ in the unwritten law. Thus s20 would not provide a remedy in this instance.

#### (d) **Unconscionability— Section 21 and 22 *Australian Consumer Law***

Section 21 proscribes unconscionable conduct in connection with the supply or possible supply, or acquisition or possible acquisition, of goods or services. There is no reference to the need for these goods to have been supplied, or acquired, for personal use. Sub-section four of s21 specifically states Parliament’s intention that the court in considering the section can take into account the terms of the contract, how the contract is carried out, and is not limited to circumstances leading to the formation of the contract. These sections are expressly not confined to the non-

<sup>74</sup> *Qantas Airways Ltd v Dillingham Corporation* [1987] A.C.L 35-692.

<sup>75</sup> *Legione v Hately* (1983) 152 CLR 406, 444 (Mason and Deane JJ); *Stern v McArthur* (1988) 165 CLR 489, 513 (Brennan J)

<sup>76</sup> However, in a subsequent case a narrower approach to unconscionability was evident in this context: *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, where the joint reasons dismissed the argument regarding unconscionability on the basis that the ‘terminator’ had not caused or contributed to the breach by the party seeking relief (Gleeson CJ McHugh Gummow Hayne and Heydon JJ, 335).

written law understanding of unconscionability, so their application is *potentially*, and intentionally, broader than that of s20. That phrasing is considered necessary because in relation to their predecessors, s51AB and s51AC of the *Trade Practices Act 1974* (Cth), the courts generally took quite a conservative view of their ambit. Specifically, courts were often reluctant to find unconscionability under these sections included substantive unconscionability, at least unless there was also evidence of procedural unconscionability.<sup>77</sup>

On the other hand, there is some judicial recognition of the fact that the requirements of then s51AC are, or should be, quite different than the requirements of then s51AA and the unwritten law of unconscionability.<sup>78</sup> As a result, it is hoped that courts interpreting s21 and s22 will not take an overly narrow view of the sections, reading into them requirements of procedural unconscionability in order for the sections to operate. The fact that the sections now specifically state that it is Parliament's intention that their interpretation not be limited by the common law of unconscionability,<sup>79</sup> and that the court in assessing the applicability of the section can look at the terms of the contract, and is not limited to aspects relating to contract formation,<sup>80</sup> should help, although one can never be entirely sure until the precedents have been set. It remains to be seen whether the comments in *Hurley* regarding the need to look beyond the terms of the contract (in the context of former s51AA, AB and AC) will be held applicable to the new regime, although it is hoped this does not occur given the new wording.<sup>81</sup>

The Courts generally applied s51AB and s51AC quite strictly, requiring a finding of serious misconduct before the sections were breached:

77 For example, the Full Federal Court in *Hurley v McDonald's Australia Ltd* found that 'before s51AA, s51AB or s51AC will be applicable, there must be some circumstance other than the mere terms of the contract itself that would render reliance on the terms of the contract 'unfair' or 'unreasonable' or 'immoral' or 'wrong': (2000) ATPR 41-741, 29-31; see also Nicholson J in *Australian Competition and Consumer Commission v Lux Pty Ltd* [2004] FCA 926, [94]. This overt focus on procedural rather than substantive unconscionability has been criticised: Stephen Corones and Sharon Christensen *Comparison of Generic Consumer Protection Legislation* (2007) p128; Zipser 'Unjust Contracts and the Contracts Review Act' (2001) 17 *Journal of Contract Law* 76; Frank Zumbo 'Promoting Ethical Business Conduct: The Case for Reforming Section 51AC' (2008) 16 *Trade Practices Law Journal* 132, 133-134; Anthony Gray 'Unfair Contracts and the Consumer Law Bill' (2009) 9(2) *QUT Law and Justice Journal* 155, 161-163.

78 *Tonto Home Loans Australia Pty Ltd v Tavares* [2011] NSWCA 389, [291]; *Australian Securities and Investment Commission v National Exchange Pty Ltd* (2005) FCAFC, [30].

79 S21(4)(a).

80 S21(4)(c).

81 Interestingly, Russell Miller in his *Australian Competition and Consumer Law Annotated* (2012) p1693 refers to the *Hurley* comments in the annotations to new s22, despite the insertion of the provisions of s21(4) stating that Parliament's intentions are that the section can include consideration of the terms of the contract etc. In *ACCC v Simply No-Knead (Franchising) Pty Ltd*, the Court was prepared to consider substantive unconscionability in assessing breach of s51AC: (2000) 104 FCR 253.

For conduct to be regarded as unconscionable, serious misconduct or something clearly unfair or unreasonable must be demonstrated ... Whatever unconscionable means in sections 51AB and 51AC, the term (means) ... actions showing no regard for conscience, or that are irreconcilable with what is right or reasonable ... The various synonyms used in relation to the term 'unconscionable' import a pejorative moral judgment.<sup>82</sup>

Section 22 sets out matters that the court may have regard to for the purposes of s21.<sup>83</sup> Those considered particularly relevant to the context of termination for convenience clauses include subsections (a) the relative strengths of the bargaining position of the parties; (b) the extent to which the party complained about was willing to negotiate terms and conditions; (c) the terms and conditions; (d) the conduct of the party complained about in complying with contractual terms and conditions, including after the contract was formed; (e) whether the party complained about has a contractual right to vary unilaterally a term or condition of the contract between the supplier and the customer;<sup>84</sup> and (f) the extent to which both parties acted in good faith.

### ***Other Arguments***

Detailed consideration of the doctrine of unjust enrichment as another ground upon which termination for convenience clauses might be challenged will not be pursued here. The High Court has on one view discouraged the development of such a doctrine as a unifying concept in itself.<sup>85</sup> On the other hand, there are some references in High Court authority to the use of such a concept in deciding upon relief.<sup>86</sup> It remains unclear whether the principle has any extra application

82 *Hurley v McDonalds Australia Pty Ltd* (2000) 22 ATPR 41-741, 40 585 (Heerey, Drummond and Emmett JJ); *Cameron v Qantas Airways Ltd* (1994) 55 FCR 147, 179; *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246, 283-284; *Attorney-General (NSW) v World Best Holdings Pty Ltd* (2005) 63 NSWLR 557, Spigelman CJ spoke of unconscionability as involving a kind of 'moral obloquy' rather than mere unfairness or unjustness: [121].

83 Subsection (1) applies where the argument is that the supplier has engaged in unconscionable behaviour, subsection (2) where the argument is that the purchaser has engaged in unconscionable behaviour. In the United States, s2-302 of the *Uniform Commercial Code* embraces the notion of unconscionability as being applicable to terms of the contract, not just circumstances leading to formation.

84 In the ACCC's *Guide to Unfair Contract Terms* (2010) it states that a unilateral variation clause would be more acceptable if it were reciprocal and provided reasons for its exercise, rather than being available at will: p14. This was in the context of the unfair contract provisions, and is not from a court, but these sentiments may prove useful in interpreting new s22.

85 *Farah Constructions v Say-Dee Pty Ltd* (2007) 230 CLR 89, 156 (Gleeson CJ Gummow Callinan Heydon and Crennan JJ).

86 *Eg Stern v McArthur* (1988) 165 CLR 489, 527 per Deane and Dawson JJ explaining unconscionable conduct in terms of a person taking advantage of another's special vulnerability 'for the unjust enrichment' of themselves, references to a 'windfall' to the terminator as a reason for relief (529); *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, 349 (Kirby J), 365 (Callinan J).

beyond the realms of conduct from which equity would traditionally regard as being deserving of relief. It is also difficult to deal with issues surrounding termination for convenience clauses by arguing that the parties are in a fiduciary relationship with one another. The courts are particularly reluctant to impose fiduciary obligations in standard contractual arrangements,<sup>87</sup> for good reason. The recognition that a relationship is fiduciary in nature means that the fiduciary is expected to subjugate their private interests in favour of the beneficiary. It is problematic to apply this concept to the vast majority of commercial contracting relationships, where it is expected that parties act in their own best interests. Nor will I press here an argument that if one party has a unilateral power of termination, they have not actually promised anything to the other, leading to problems with consideration.<sup>88</sup>

### ***Summary of Findings and Conclusion***

In sum, my discussion of possible remedies for a party against whom a termination for convenience clause has or might be exercised has found the following:

- s23 of the *Australian Consumer Law*, the unfair contract term provisions, won't help;
- good faith may help, particularly if the fourth understanding of the term is applied (reasonableness)(see below), maybe if the third understanding of the term is applied (preventing a party using a contractual power other than the purpose for which it was conferred)(see below), but probably not if the first understanding of the term is applied (honesty)(see below). The second understanding of the term, preventing the other from meeting their obligations under the contract, doesn't apply.
- non-statutory unconscionability won't help because it traditionally won't consider substantive unconscionability, which is what a termination for convenience clause would be argued to be, and the party complaining in a business context can't meet the special disadvantage test the courts apply
- statutory unconscionability, particularly s21 and s22 of the *Australian Consumer Law*, can and should be applied (see below)
- of the other possible arguments, there is some argument regarding unjust enrichment if a party exercises a termination for convenience clause arbitrarily, and that such a clause undermines consideration (these won't be further considered as there is limited support in the case law), but not in relation to fiduciary duties.

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87 *Hospital Products v United States Surgical Corporation* (1984) 156 CLR 41.

88 One example of this finding is *Torncello v United States* 681 F.2d 756, 768-772 (1982) (Bennett J)(Court of Claims).

## *Examples*

I will conclude the article by considering some of the examples of the exercise of a termination of convenience clause that I have seen in practice, to see the extent to which any of the above principles might be applicable. A relevant consideration here might be the reason/s why the client/principal is exercising their right of termination, so the examples will posit different reasons to see whether the application of the above principles might lead to different results depending on why the terminating party exercised the option.

*Scenario One: The principal/client can terminate at their convenience, subject to payment to the terminated contractor for all work completed up until the date of termination, as well as demobilization costs associated with early termination.*

The principal/client is not acting dishonestly here, in the narrow sense of good faith. Arguably, they are not acting unreasonably either, at least in terms of their willingness to pay appropriate, though minimal, compensation to the terminated contractor. It is difficult to argue this conduct involves the kind of ‘serious misconduct’ or ‘clearly unfair or unreasonable’ conduct that would attract s21 of the *Australian Consumer Law*.

*Scenario Two: The principal/client can terminate at their convenience. No compensation is payable to the contractor in that event.*

The author is not aware of a case where a court has considered the validity of such a clause. The terminator is not acting dishonestly here, so good faith would not apply if that concept is applied narrowly. There may be an argument that a failure to compensate the contractor, at least for the work done up until the time of termination and associated demobilisation costs, is unreasonable and contrary to good faith in the broader sense of the word. There is academic support for the suggestion that in such cases the court should require the terminator to pay the terminated contractor some compensation, at least to the extent of the work done until the date of termination and reasonable demobilisation expenses.<sup>89</sup> This may also be a case where the court would view the contractual clauses here as ‘clearly unfair or unreasonable’, taking into account the fact it is a right to unilateral variation, and probably reflective of the client’s superior bargaining power. This could lead to the kind of ‘windfall’ or ‘unjust enrichment’ that has concerned some of the judges in the unconscionability cases to date.

*Scenario Three: The principal/client can terminate at their convenience. They do so because they have found a new contractor who is quoting a cheaper price than the current contractor.*

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89 Charles Tiefer ‘Forfeiture by Cancellation or Termination’ (2003) 54 *Mercer Law Review* 1031, 1076.



There are good arguments to be made that such conduct is contrary to good faith. Here, the definition of good faith becomes critical. If good faith is confined to honesty, these actions would not fall foul of it – there is nothing dishonest in what the terminator is doing. However some, including the author, would argue that when the broader definition of good faith is applied, including notions of reasonableness, it is unreasonable for the terminator to exercise their right in such circumstances. The terminator is seeking to take an opportunity foregone by the entry into the contract, the conduct seems contrary to the spirit of the contract. Some would view this behaviour as immoral.<sup>90</sup>

This may also be viewed as unconscionable within s21 of the *Australian Consumer Law*, involving ‘moral obliquity’ or ‘clearly unfair or unreasonable’ behaviour, in seeking to take back foregone opportunities, where the context in which the contract was developed has not particularly changed. This is a unilateral right to terminate and probably again reflects disparity in bargaining position.

*Scenario Four: The principal/client can terminate at their convenience. They were genuinely committed to the project at the time of signing, but an event like the global financial crisis occurred, throwing out their project plans ie capital is more expensive, more difficult to secure etc.*

A good faith argument is difficult to make here. There is no suggestion of dishonesty. It would be open to a court to find here that the exercise of the termination power is reasonable in the circumstances. The terminator is not acting for a purpose contrary to the contract, has not failed to co-operate to achieve the contract’s objectives, and is not seeking to take advantage of opportunities foregone when the contract was executed. Some support for this approach can be taken from the American case law. In one of the leading cases, *Torncello v United States*, the court rejected blanket acceptance of the validity of termination for convenience clauses, finding limited justification for them in terms of situations where the expectations of the parties had substantially changed.<sup>91</sup> For similar reasons, it is hard to argue that s21 unconscionability exists here, with the lack of serious misconduct or clearly unfair or unreasonable behaviour on the client’s part.

90 Summers uses a similar example of a purchaser who has an unqualified right to reject goods tendered by the supplier, who exercises that right to reject goods because they have found a cheaper alternative supplier. He considers this conduct to be commercial bad faith: ‘Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code’ (1968) 54 *Virginia Law Review* 195, 206.

91 681 F.2d 756, 763 (1982)(Court of Claims): it was noted that this was consistent with the original context in which the use of such clauses arose, namely government contracting during wartime, where the government needed flexibility due to the unpredictable world situation, and their need for services from contractors; *Russell Motor Car Co v United States* 261 US 514 (1923).

*Scenario Five: The client can terminate at their convenience. They are a head contractor, and a termination for convenience clause appears in their contract with the principal (for example, the Western Australian Government calls tenders to build a new rail line in the State. John Holland is appointed head contractor, and they appoint various sub-contractors. John Holland makes the clause 'back to back' ie inserts the clause in contracts with their sub-contractors, in case the WA Government exercises their option. John Holland does not want to be left 'in the lurch' contractually, if their contract with the Western Australian government falls over.*

Again, it would be difficult to argue that the head contractor is acting in bad faith. There is again no suggestion of dishonesty. It is open for a court to find the exercise of the termination power reasonable in the circumstances. The terminator is not acting for a purpose contrary to the contract, failed to co-operate to achieve the contract's objectives, and is not seeking to take advantage of opportunities foregone when the contract was executed. Similarly, it is difficult to make out an allegation of 'serious misconduct' or 'clearly unfair or unreasonable' behaviour on the client's part.