

Termination for Convenience Clauses and Good Faith

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Abstract. *This article considers the legal validity of so-called termination for convenience clauses, which allow at least one party to the contract to terminate the contract without cause. Such rights are in contrast to more traditional approaches to contractual termination, which distinguished between breaches of condition and breaches of warranty, allowing termination only for the former. Specifically, it will be asked whether such termination for convenience clauses are consistent with requirements of good faith in contracting, the existence of which is itself contentious. As a result, it will be necessary to consider the current state of the law in Australia and elsewhere in relation to the extent to which good faith is and should be a feature of contracting.*

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1. Introduction

Clauses allowing at least one party to the contract¹ to terminate the contract without cause are an increasing feature of contracting in Australia. An example of such a clause for discussion purposes appears in the standard form contract of a major Australian construction company. It states that

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 the following amounts as reasonably determined by the contractor:

The value of all good supplied in accordance with the agreement, to the date of termination (less any amounts already paid to the supplier in respect of that supply; and

All reasonable direct costs incurred by the supplier as a result of termination (subject to an obligation on the supplier to mitigate such costs).

Whilst it is perfectly understandable that a party to the contract might wish to provide this kind of flexibility in case their circumstances change, it raises the question of whether a party to a contract should always have the ability to exercise such a right, whether some limits should exist to the use of such a right, or whether such a right should not be allowed to be exercised at all. Various legal issues arise in relation to the exercise of such a right; for the purposes of this article, I will focus particularly on contentious good faith doctrine, and the extent to which it may have a role in regulating the exercise of such a right. Such clauses occur within the broader context of the notion of freedom of contract, and questions regarding the extent to which it is proper for a court to review the substantive terms of contracts that might appear particularly favourable to one party over the other, or contain clauses that are arguably unfair.

I should make clear some issues that I believe to be generally outside of the ambit of my present purposes here:

¹ Some contracts provide either party with the right to terminate the contract at their convenience.

- a) The extent to which good faith is or should be an organising principle for a range of recognised equitable concepts such as unconscionability, duress, undue influence, misrepresentation, breach of fiduciary duty, relief against forfeitures, unjust enrichment;
- b) Whether good faith is a term to be implied in law or in fact, or considered to be a general principle of contractual construction²
- c) The exact scope of the obligation (if any) to act in good faith.

All of these matters have already been the subject of a large volume of literature. I will only address these matters to the extent believed necessary to answer the immediate question regarding termination for convenience clauses, though I am aware of the much larger context in which such questions operate.

2. Some Background on Good Faith in Contracts

The notion of good faith in contracting is of ancient lineage. It has existed at least since the development of Roman law,³ and some say it preceded the development of natural law.⁴ It was associated with trustworthiness, conscientiousness and honourable conduct.⁵ Tetley writes that the concept of good faith as an implicit principle governing performance of contracts continued during the eleventh and twelfth centuries, and was generally adopted in the civil law world.⁶ The civil law world continues to accept the doctrine.⁷

There was an initial acceptance of the doctrine in the common law. A good example of this appears in the decision of leading commercial law jurist Lord Mansfield in the insurance case of *Carter v Boehm*.⁸ Lord Mansfield stated there that

Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lies most commonly in the knowledge of the insured only; the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstances in his knowledge; to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk, as if it did not exist. Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain from his ignorance of that fact.

He reiterated in subsequent cases that 'by the law of merchants, all dealings must be fair and honest'.⁹ As we know now, the common law developed in a different direction, with the general abandonment of the concept of 'good faith', not surprisingly during the rise of concepts of freedom of contract and liberalism, and the rise of positivism at the expense of notions of natural law.¹⁰ The familiar debate between certainty and flexibility has occurred in this context. For instance Rogers CJ Comm D noted that¹¹

² See for example John Carter and Elisabeth Peden 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155; Elisabeth Peden *Good Faith in the Performance of Contracts* (2003); Elisabeth Peden 'Incorporating Terms of Good Faith in Contract Law in Australia' (2001) 23 *Sydney Law Review* 222; Elisabeth Peden 'Implicit Good Faith' – Or Do We Still Need an Implied Term of Good Faith?' (2009) 25 *Journal of Contract Law* 50; Bill Dixon 'Good Faith in Contractual Performance and Enforcement – Australian Doctrinal Hurdles' (2011) 39 *Australian Business Law Review* 227.

³ N W Palmieri 'Good Faith Disclosures Required During Pre-Contractual Negotiations' (1993) 24 *Seton Hall Law Review* 70, 80.

⁴ W T Tete 'Tort Roots and Ramifications of the Obligations Revision' (1986) 32 *Loyola Law Review* 47, 58.

⁵ J F O'Connor *Good Faith in International Law* (1991) p117.

⁶ William Tetley 'Good Faith in Contract, Particularly in the Contracts of Arbitration and Chartering' (2004) 35 *Journal of Maritime Law and Commerce* 561, 567.

⁷ Eg French Civil Code 1804, German BGB (references needed), Chinese Contract Law.

⁸ (1766) 3 Burr. 1905, 97 ER 1162.

⁹ *Pawson v Watson* (1778) 2 Cowp 786, 788.

¹⁰ Some argue that this development ignored the relationship aspects of contracting, assuming the parties were not in an ongoing relationship: Woo Pei Yee 'Protecting Parties' Reasonable Expectations: A General Principle of Good Faith' (2001)

against a trend towards a general obligation of good faith, fairness or reasonableness, there have been judicial comments to the effect that the courts should be slow to intrude into the commercial dealings of the parties who are quite able to look after their own interests. The courts should not be too eager to intervene in the commercial conduct of the parties, especially where all parties are wealthy, experienced commercial entities able to attend to their own interests.

On the other hand, Allan Farnsworth says

Part of the strength of such general concepts as good faith and commercial reasonableness lies in an elasticity and lack of precision that permits them to be ... developed by the courts in the light of unforeseen and new circumstances and practices¹²

The concept of 'good faith' has continued to underpin contracts of insurance, an issue to which we shall return later in this paper.

The question of 'good faith' in contracts is, at least by that moniker, of relatively recent origin in Australia. The British tradition did not generally¹³ recognise a tradition of 'good faith', at least by that description, in the common law.¹⁴ I must add the rider 'at least by that description' because the common law did recognise other doctrines that might deal with the kinds of behaviour that good faith would, with a similar outcome. For

1 *Oxford University Commonwealth Law Journal* 195, 197; Bill Dixon 'Common Law Obligations of Good Faith in Australian Commercial Contracts – A Relational Recipe' (2005) 33 *Australian Business Law Review* 87.

¹¹ *GSA Group Pty Ltd v Siebe PLC and Another* (1993) 30 NSWLR 573, 579; Kirby P in *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130, 132-133: 'the law of contract which underpins the economy does not ... operate uniformly upon a principle of fairness'; 'men of full and competent understanding shall have the utmost liberty of contracting' (Sir George Jessel MR in *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462, 465; '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' (*Allen v Flood* [1898] AC 1, 46 (Wills J)); Tyrone Carlin 'The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25 *University of New South Wales Law Journal* 99; Adam Wallwork 'A Requirement of Good Faith in Construction Contracts' (2004) 20 *Building and Construction Law* 257, 265 noting a 'strong preference for the High Court to reject the general implication of a term of good faith into all commercial contracts. The potential existence of this implied term is creating uncertainty for parties when they wish to exercise express contractual rights and powers and is prolonging negotiations as parties seek to reinforce apparently clear contractual rights'. The Privy Council cast doubt on the application of the concept of 'unconscionability' in relation to contracts due to the uncertainty created: *Union Eagle Limited v Golden Achievement Limited* (Hong Kong)[1997] UKPC 5, para 8.

¹² 'Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code' (1963) 30 *University of Chicago Law Review* 666, 676. It is sometimes said the argument that good faith leads to too much uncertainty in contracting is overdone: Justice Steyn 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair Shirt Philosophy?' (1991) 6 *Denning Law Journal* 131, 140. The debate also involves the issue of whether generalised standards should be applied to all contracts, or particular rules worked out in individual cases: compare for instance the comments of Gummow J in *Service Station Association Limited v Berg Bennett and Associates Pty Limited* (1993) 45 FCR 84, 96: 'Anglo-Australian contract law as to the implication of terms has ... developed differently, with greater emphasis upon specifics, rather than the identification of a genus expressed in wide terms', with the comments of Finn J in *Hughes Aircraft Systems International v Aircservices Australia* (1997) 146 ALR 1, 37 'unlike Gummow J, I consider a virtue of the implied duty to be that it expresses a generalisation of universal application, the standard of conduct to which all contracting parties are to be expected to adhere throughout the lives of their contracts. This debate has obvious parallels with another area of the law of obligations, that of negligence, where originally discrete categories of case in which a duty of care would be recognised (*Heaven v Pender* (1883) 11 QBD 503), were eventually replaced with the generalised neighbour test of *Donoghue v Stevenson* [1932] AC 562.

¹³ Cf the early case of *Mellish v Motteux* (1792) Peake 156, 157; 170 ER 113, where the court concluded that it should compel standards of honesty and good faith in all contracts. As to the question of globalisation and harmonisation of legal systems (or otherwise) in the area of good faith, see Gunther Teubner 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences' (1998) 61 *Modern Law Review* 11.

¹⁴ *Walford v Miles* [1992] 2 AC 128 (H.L.), there in the context of a suggested duty to negotiate in good faith, which the House of Lords rejected.

example, the court in the older case of *Mackay v Dick*¹⁵ recognised a general (implied) contractual obligation to do all that is reasonably necessary to facilitate performance of a contract. While the decision was not based expressly on the notion of good faith, obviously that type of sentiment is analogous to a good faith approach to contracts. The court referred in *Hillas and Co v Arcos Ltd*¹⁶ to the ‘legal implication in contracts of what is reasonable’.¹⁷ In a line of cases, Australian courts have found that a party to a contract must exercise a right to rescission in a reasonable way.¹⁸ The court’s recognised ability to relieve against forfeiture of property rights has been expressed in ways that would allow its application to broader circumstances not involving loss of property rights.¹⁹ The doctrines of unconscionability, estoppel, unjust enrichment, and fiduciary duties²⁰ may also play a part.²¹

Good faith is reflected in international materials,²² including the Uniform Commercial Code,²³ Restatement (Second) of the Law of Contracts,²⁴ and United Nations Convention on Contracts for the International Sale of Goods.²⁵ Generally, the law makes it very difficult to imply terms into contracts; if it is to be an implication of fact, it must generally (at least, according to current law) meet the stringent requirements of BP Refinery

¹⁵ (1881) 6 AC 251; see also *Butt v McDonald* (1896) 7 QJL 68; *Butts v O’Dwyer* (1952) 87 CLR 267; *CSS Investments Pty Ltd v Lopiron Pty Ltd* (1987) 76 ALR 463; *Secured Income Real Estate (Australia) Limited v St Martins Investments Proprietary Limited* (1979) 144 CLR 596; *Burrows ‘Contractual Co-Operation and the Implied Term’* (1968) 31 *Modern Law Review* 390. The early United States case is similar: ‘in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing’: *Kirke La Shelle Co v Paul Armstrong Co* 263 NY 79, 188 NE 163 (1933); Elisabeth Peden ‘Cooperation in English Contract Law’ (2000) 16 *Journal of Contract Law* 56.

¹⁶ [1932] All ER 494, 507 (Lord Wright).

¹⁷ Cf ‘it never has been the law that a person is only entitled to enforce his contractual rights in a reasonable way’: *White and Carter (Councils) Ltd v McGregor* [1961] UKHL 7 (Lord Reid).

¹⁸ *Godfrey Constructions Pty Limited v Kanangra Park Pty Ltd* (1972) 128 CLR 529, 543 (Walsh J asked whether the right of rescission was exercised in an arbitrary or unreasonable way, in terms with which Gibbs J agreed (547), Stephen J spoke of reasonableness and whether the power of rescission was exercised for the purpose/s contemplated in the contract (552); Barwick CJ, with whom McTiernan J agreed, preferred the language of ‘unconscionability’ in assessing the vendor’s exercise of power of rescission (538). In *Pierce Bell Sales Pty Limited v Frazer and Another* (1972) 130 CLR 575 Barwick CJ (with whom McTiernan J agreed) considered whether the respondents were exercising their right of rescission in an ‘unreasonable or unconscionable’ way (589), and Gibbs J (following *Selkirk v Romar Investments Ltd* [1963] 1 WLR 1415) asked whether the vendor was exercising their rights in an arbitrary, capricious or unreasonable way (591). In *Legione v Hately* (1983) 152 CLR 406 all judges reasserted this power, with Mason and Deane JJ concluding that relief against forfeiture would be available where the vendor was ‘taking unconscientious advantage of the benefits which will fortuitously accrue to him on forfeiture of the purchaser’s interest under the contract’ (449). Gibbs CJ and Murphy J also granted relief against forfeiture, on the basis that its exercise would deliver a windfall to the vendor, the purchaser’s breach was not serious, and that the windfall was disproportionate to the detriment they suffered from the purchaser’s breach (429).

¹⁹ So, for example, in *Shiloh Spinners Ltd v Harding* [1973] AC 691, Lord Wilberforce discussed relief against forfeiture of rights in relation to a lease, and confirmed equity’s ability to protect from unjust forfeiture of property rights; Lord Simon in the case took a broader view, citing equity’s ‘unlimited and unfettered jurisdiction to relieve against contractual forfeitures and penalties’ (726).

²⁰ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41.

²¹ Sir Anthony Mason ‘Contract, Good Faith and Equitable Standards in Fair Dealing’ (2000) 116 *Law Quarterly Review* 66; Paul Finn ‘Commerce, The Common Law and Morality’ (1990) 17 *Melbourne University Law Review* 87.

²² See 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, and Article 1.201 of the Principles of European Contract Law.

²³ Section 1-203 states that every contract or duty within the Act imposes an obligation of good faith in its performance or enforcement. Good faith is defined in s1-201 to mean honesty in fact in the conduct of the transaction concerned. In the sales article (2-103), good faith was defined more broadly to include both honesty and reasonable standards of fair dealing in the trade. The *Restatement of Contracts (Second)* imposes a duty of good faith and fair dealing in the performance and enforcement of a contract (s205). The New York Court of Appeals recognised a good faith obligation in *Wigand v Bachmann-Bechtel Brewing Co* 118 NE 618, 619 (1918). In another case,

²⁴ Section 205 states that every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement.

²⁵ Article 7(1) required the observance of good faith in international trade in interpreting the convention; Elena Christine Zaccaria ‘The Dilemma of Good Faith in International Commercial Trade’ (2004) 1 *Macquarie Journal of Business Law* 101.

(*Westernport Pty Ltd v Shire of Hastings*;²⁶ if an implication of law, it will be made only in relation to a specified class of contracts.

This changed with the New South Wales Court of Appeal decision in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*²⁷ where a majority of the Court recognised good faith obligations. The context was a clause allowing a principal to issue a show cause notice to a contractor who had not met their contractual obligations as to why the principal should not exercise their rights to terminate the contract and/or take over the works.

A majority of the court found that the exercise of the principal's rights in this regard were subject to an overriding obligation of 'reasonableness'; this obligation could be derived either as an implication of fact,²⁸ or an implication of law.²⁹ In justifying their view, the majority referred to a situation where a contractor had committed a trivial breach of contract, to which the principal might have responded with a show cause notice. The contractor may not have responded, or responded adequately:

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 ... 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 subject 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 the way I have indicated, that is as subject to requirements of reasonableness.³⁰

Priestley JA stated that this concept of 'reasonableness' had much in common with the requirement of good faith, noting the extent to which such doctrine had been accepted internationally, and the fact that the recognition of such a doctrine in a commerce-based nation such as the United States had not caused great difficulty. He used the international materials and experience to conclude that Australian law should move towards recognition of the doctrine.³¹

The British Columbia Law Institute has recently called for the introduction of a good faith requirement in the performance of contracts: *Consultation Paper on Proposals for Unfair Contracts Relief* (2011).

²⁶ (1977) 180 CLR 266, 282-283; (1) that the term must be reasonable and equitable, (2) necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it, (3) must be so obvious that it goes without saying, (4) must be capable of clear expression, and (5) must not contradict any express terms of the contract. Even if the first four requirements could be met, the parties would be free to expressly exclude good faith from their contracts, pursuant to the fifth.

²⁷ (1992) 26 NSWLR 233.

²⁸ Precedent regarding an implication of fact has determined that it must be reasonable and equitable, necessary to give business efficacy to the contract so that no term would be implied if the contract were effective without it, had to be so obvious that it had to go without saying, capable of clear expression, and could not be inconsistent with any express terms of the contract: *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 66. This is a contract by contract question, based on the parties' actual intention.

²⁹ Implication by law is based on imputed intention rather than actual intention, and applies to a particular class or category of contracts, rather than being a contract by contract question.

³⁰ 258 (Priestley JA, with whom Handley JA agreed (279)).

³¹ 267-268 (Handley JA did not address the point specifically but expressed general agreement with Priestley JA's comments (279)).

Further support for the doctrine at the appellate level appears in *Alcatel Australia Ltd v Scarcella*,³² *Burger King Corporation v Hungry Jack's Pty Ltd*,³³ and supportive comments appear in many single judge decisions.³⁴ According to the Court in *Burger King*, an aspect of the requirement of good faith was that termination rights be exercised reasonably, so it could not be used to achieve a purpose foreign to the purpose for which it was granted.³⁵ The court also noted that the obligation of 'good faith and reasonableness' would more readily apply in standard form contracts, particularly those containing a general power of termination.³⁶

However, other appellate courts, including the High Court and the judgments of judges who would later join the High Court, have been less supportive. Typically, freedom of contract and the need for contractual certainty have been emphasised. The Victorian Court of Appeal suggested in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL*³⁷ that good faith introduced uncertainty in contracting, and that its scope might be limited to cases where the relationship between the parties was 'unbalanced' and one party was at a serious disadvantage or was particularly vulnerable in the current context. Warren CJ suggested the obligation would not exist where 'two commercial leviathans' were contractually engaged.³⁸ Buchanan JA, with whom Osborn AJA agreed, found that good faith might have some application to protect a vulnerable party from exploitative conduct which subverts the original purpose for which the contract was made, but otherwise was hesitant to generally apply the doctrine, lest it subverted the legitimate interests of a party to the contract. Buchanan JA suggested this limitation may have very limited scope.³⁹

The High Court was invited to clarify the position in *Royal Botanic Gardens and Domain Trust v South Sydney City Council*,⁴⁰ but declined to do so. The joint reasons pointed out that both parties conceded the application of such a doctrine to the facts, differing as to its scope. The joint reasons concluded the issues surrounding the existence and scope of good faith were important, but declined to consider them given that it was not necessary to do so given their finding on other matters.⁴¹ There is an oblique reference to good faith in the judgment of Mason CJ and Dawson J in *Commonwealth v Amann Aviation Pty Ltd*,⁴²

³² (1998) 44 NSWLR 349, where Sheller JA (with whom Powell JA and Beazley JA agreed) claimed that a contractual power could be read down if it was wider than necessary to protect the legitimate interests of that party, or where it was being used in a capricious or arbitrary way or for an extraneous purpose (368), equating the jurisdiction with unconscionability (with reference to *Pierce Bell Sales Pty Ltd v Frazer* (1973) 130 CLR 575, 587).

³³ [2001] NSWCA 187, where the Court was concerned that unless there was an implied requirement of reasonableness and good faith, 'Burger King could, for the slightest of breaches, bring to an end the very valuable rights which Hungry Jack's Pty Ltd had under the (contract)(para 183)(Sheller JA, Beazley JA and Stein JA).

³⁴ *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703 (Finkelstein J accepting an implied term of good faith in law, suggesting it apply to all commercial contracts, equating good faith with fairness, and specifically stating that good faith should temper a contractual right to terminate [35]); Finn J in *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151, 192 'more open recognition (of an implied term of good faith) in our own contract law is now warranted'; *Far Horizons Pty Ltd v McDonalds Australia* [2000] VSC 310; *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 17 (Barrett J); *Commonwealth Bank of Australia v Spira* [2002] NSWSC 905 (Gzell J); *Biscayne Partners Pty Ltd v Vallance Corp Pty Ltd* [2003] NSWSC 874 (Einstein J).

³⁵ 573-574.

³⁶ 569.

³⁷ [2005] VSCA 228; see also *Vodafone Pacific Ltd v Mobile Innovations Ltd* (2004) NSWCA 15; *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108; *GSA Group Pty Ltd v Siebe PLC* (1993) 30 NSWLR 573, 579 (Rogers CJ); *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130, 132-133 (Kirby P).

³⁸ Para 3-4 (Warren CJ).

³⁹ 'It is difficult to discern a want of good faith in the exercise of a power which can serve only the interests of the party upon whom the power is conferred' (Buchanan JA, para 23)(with whom Osborn AJA agreed).

⁴⁰ (2002) 240 CLR 45; 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.

⁴¹ 63 (Gleeson CJ Gaudron McHugh Gummow and Hayne JJ); nor did Callinan J consider them, though he described them as 'far-reaching' (94), which (respectfully) might mean for that judge that he was generally disapproving of the suggestion. Kirby J rejected the suggestion of an implied term of good faith on the basis it was contrary to caveat emptor principles and those relating to the implication of terms in contracts (75-76). Gummow J, when a judge on the Federal Court, was similarly unimpressed: 'a promise to negotiate in good faith may be illusory': *Service Station Association Limited v Berg Bennett and Associates Pty Limited* (1993) 45 FCR 84, 92.

2.1 *Lord Mansfield and Carter v Boehm*

It is suggested that the answer to the question of the extent to which good faith should be considered applicable to all contracts might be found in the history of the development of the principle, from the early common law case of *Carter v Boehm*, to which reference was made earlier in this article. As indicated, Lord Mansfield in that case found that a duty of good faith existed on the facts. This was a question of non-disclosure in relation to an insurance contract. Lord Mansfield's stated reason for applying the requirement of disclosure (good faith) in that case was that 'the special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only'.

In other words, the *Carter v Boehm* decision can be explained by virtue of economic principles.⁴³ The general assumptions upon which the rules of contract are framed include that both parties are well-informed and can make rational decisions about what is in their best interests.⁴⁴ However, Lord Mansfield recognised that sometimes, these assumptions did not hold. The reality was that, on occasion, one party was in a superior bargaining position to the other, because one might know something that the other did not (could not) know. For this reason, Lord Mansfield was prepared to invoke the obligation of good faith. Another aspect of this approach, not enunciated by his Lordship but thought to be equally applicable, is the idea that parties need to fully appreciate the risks they are being asked to take on when signing up to a contract with another. In most cases, parties are able to adequately assess these risks, and can price the contract accordingly. We see this assumption in the general (common law) contractual rule that 'consideration need not be adequate'.⁴⁵ The court will generally not weigh up the value of promises made pursuant to a contract, because it makes the assumption that the parties are rational, utility maximisers who believe, having weighed up the risks and benefits, that the contract is a favourable one for them.

However, this assumption does not hold where one of the parties is at an information disadvantage, in that they have inferior knowledge of the risks and benefits associated with the contract. If these risks and benefits were known or reasonably knowable by a party, the law might reasonably conclude that the ignorant party was at fault in not making these reasonable investigations, reflecting the generally sound principle that parties should be encouraged to take responsibility for their own decisions, and make sure they have researched adequately prior to making decisions regarding the entry into contracts and upon what terms.⁴⁶ However, if these risks and benefits were not known or reasonably knowable by a party, the issues are more complex, particularly where

⁴² (1991) 174 CLR 64, 96, suggesting that the exercise of the contractual right of a party to terminate the contract 'called for something more on his part than a mere pursuit of what was to the advantage, or in the interests, of (their employer)' (though the judgment does not expressly rely on a concept of 'good faith').

⁴³ Others have made the same point: see for example Thomas Schoenbaum 'The Duty of Utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law' (1998) 29 *Journal of Maritime Law and Commerce* 1, 3: 'the rule of utmost good faith is grounded in economic efficiency. It is a rule designed to minimise costs to both insurers and assureds. Investigation of risks cost money. In maritime insurance cases, the particulars of the risks are peculiarly within the knowledge of the assured. The rule places the onus on the party with exclusive knowledge or circumstances affecting the risk to disclose so that the risks can be most precisely and cheaply evaluated'; other economic arguments in favour of recognising an obligation of good faith appear in Arlen Duke 'A Universal Duty of Good Faith: An Economic Perspective' (2007) 33 *Monash University Law Review* 182, 194 'promoting trust and cooperation is an extremely effective way of fostering efficiency', and arguing that individuals are motivated not only by self-interest, as traditional law and economics scholars assume, but also by an internal desire for reciprocity and fairness. Some law and economics scholars are against good faith because they argue it undermines certainty of contracting (eg Robert Scott 'The Death of Contract Law' (2004) 54 *University of Toronto Law Journal* 369).

⁴⁴ John Smillie 'Is Security of Contract Worth Pursuing? Reflections on the Function of Contract Law' (2000) 16 *Journal of Contract Law* 148.

⁴⁵ *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189, 193-194; John Smillie 'Is Security of Contract Worth Pursuing? Reflections on the Function of Contract Law' (2000) 16 *Journal of Contract Law* 148: 'the adequacy of the consideration exchanged for a promise is a matter for the parties to decide, and judges must not substitute their views as to the substantive fairness of the bargains reached'.

⁴⁶ This was demonstrated in a later insurance case, where Lord Mansfield held in *Friere v Woodhouse* that 'what is exclusively known to the assured ought to be communicated, but what the underwriter, by fair inquiry and due diligence, may learn from ordinary sources of information, need not be disclosed' (1817) 1 Holt NP 572, 573.

they were known or reasonably knowable by the other party. In the mind of Lord Mansfield in *Carter*, this was the type of circumstance in which good faith was to be required, including in that case, the specific requirement of disclosure.

My argument in relation to termination for convenience clauses is that the reasons which led Lord Mansfield in *Carter* to impose the good faith obligation ie that pertinent information was not available to one side in order for them to properly weigh the risks and undertake the risk/return analysis, is also applicable to contracts with such clauses. Specifically, the party who is liable to be 'terminated' at the convenience of the other cannot know in advance of its exercise the likelihood of it being applied, or at what stage of the contract. For this reason, they cannot know the amount of profit they would lose if the clause were applied. As a result of these unknowns, they are unable to price in the risk of such a clause being included in the contract. They cannot know them. The exercise of such a right is outside the control of the contractor.⁴⁷ The party who is able to take advantage of the termination for convenience clause knows more about the likelihood that this right will be exercised against the contractor, and of course it is something that is within their control.⁴⁸

In other words, the existence of such clauses undermines the entire economic basis of a contract, as an exchange of promises by parties who are well-educated and who understand and have weighed up their rights and obligations in the contract, such that the price which the parties have agreed reflects a fair assessment by the parties of the relative risks involved.⁴⁹ If one party is not aware of the extent to which something in the contract (the right of the other to unilaterally terminate) is a risk, they cannot price it in.

2.2 Lord Mansfield, The Law Merchant, and Good Faith

Another relevant argument here is to suggest that traditional freedom of contract doctrine does not now, if it ever did, capture the substance of the relationship between contracting parties, which is often inherently based on mutual trust and confidence. The argument, from authors such as Macaulay,⁵⁰ Macneil⁵¹ and others,⁵² is that

⁴⁷ Of course, this is in contrast to more traditional 'termination for cause' situation, where the ability of one party to terminate the contract depends on the behaviour of the other.

⁴⁸ Steven Burton also claims there is economic support for a good faith requirement: 'the good faith performance doctrine may be said to enhance economic efficiency by reducing the costs of contracting. The costs of exchange include the costs of gathering information with which to choose one's contract partners, negotiating and drafting contracts, and risk taking with respect to the future. The good faith performance doctrine reduces all three kinds of costs by allowing parties to rely on the law in place of incurring some of these costs': 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1980) 94 *Harvard Law Review* 369, 393. These arguments are connected with arguments that classical contractual theory takes insufficient account of the relationship between the parties in asserting freedom of contract: Bill Dixon 'Common Law Obligations of Good Faith in Australian Commercial Contracts – A Relational Recipe' (2005) 33 *Australian Business Law Review* 87; Woo Pei Yee 'Protecting Parties' Reasonable Expectations: A General Principle of Good Faith' (2001) 1 *Oxford University Commonwealth Law Journal* 195; P Powers 'Defining the Indefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods' (1999) 18 *Journal of Law and Commerce* 333, 350: 'a world saturated with bad faith is very costly'.

⁴⁹ Economic principles also explain the other main circumstance in which termination occurs, where the contract is 'frustrated'. This occurs when performance of the contract has become something radically different from what the parties bargained for (*Davis Contractors Ltd v Fareham UDC* [1956] AC 696); in other words, their risk/return decisions do not hold, because the actual situation is so radically different from the circumstances upon which their risk/return calculations were based as to make it unjust to hold them to their original bargain.

⁵⁰ Stewart Macaulay 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55, 58 ('businessmen often prefer to rely on a man's word in a brief letter, a handshake, or common honesty and decency'), 64 ('some businessmen object that in such a carefully worked out relationship one gets performance only to the letter of the contract. Such planning indicates a lack of trust and blunts the demands of friendship, turning a cooperative venture into an antagonistic horsetrade'), 66 ('holding a customer to the letter of a contract is bad for customer relations' (after conducting an empirical survey of business owners and lawyers who advise them. He found a marked difference between how lawyers approached contracts and how business people approached contracts).

⁵¹ Ian Macneil 'Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law' (1978) 72 *Northwestern University Law Review* 854; Ian Macneil 'Relational Contract Theory: Challenges and Queries' (2000) 94 *Northwestern University Law Review* 877.

relationships were critical in business, that someone relying on fine print in contracts might not be in business for long, because they are seen to be acting unethically and contrary to the spirit of the contract. Legal sanctions for breach of contract were seen as a last resort, and implied a breakdown of the business relationship. The need to keep or earn a good reputation was a fair better explainer of actual human behaviour in a business context, than what contractual rules said. According to these writers, there is a disjunct between current rules of contract law, and actual business practice.

The argument is that if business people do value, and act as if they value, the relationship they have with the other side, and assume trust, decency or basic reasonableness from the parties with whom they contract, the law relating to the contract should reflect this.⁵³ Of course, the idea of actual practice influencing the law is not a new one; it is indeed the entire basis of the common law itself, including commercial law. Readers will be familiar with the role played by Lord Mansfield, and others, in having actual commercial practices reflected in commercial law.⁵⁴ As indicated above, perhaps not coincidentally it was also Lord Mansfield who sought to apply the principles of good faith to contracts generally, not only some types of contract. These arguments might assist on the technical question of whether a requirement of good faith is an implied term, or rather an approach to contractual construction. It might be possible, for instance, to argue that the requirement of good faith should be implied in fact, as being necessary to give the agreement ‘business efficacy’, given the relational character of contracts, as indicated by business people. Similarly, it would be easier to argue that contracts should be approached with a construction favouring good faith, because this is consistent with the relational character of contracts. As Bill Dixon concludes

As both parties reasonably expect that mutual cooperation will promote their economic interests, a party to this type of contract does not (rationally) intend to assume the risk of opportunistic behaviour, as may be the case in the traditional adversarial context.⁵⁵

3.0 Good Faith and Termination for Convenience Clauses

Use of a termination for convenience clause is often characterised as an act not in good faith.⁵⁶

In order to answer the specific question of whether the exercise of a termination for convenience clause is or may be contrary to good faith principles, it is necessary to define what is meant by the notion of good faith. This apparently simple question has yielded no clear answer. One attempt was made by Sir Anthony Mason extra-judicially. He spoke of three concepts: (a) an obligation on the parties to co-operate in achieving the contractual objects;⁵⁷ (b) compliance with honest standards of conduct; and (c) compliance with standards of conduct which

⁵² Vivien Goldwasser and Tony Ciro ‘Standards of Behaviour in Commercial Contracting’ (2002) 30 *Australian Business Law Review* 369; Bill Dixon ‘Common Law Obligations of Good Faith in Australian Commercial Contracts – A Relational Recipe’ (2005) 33 *Australian Business Law Review* 87; Alex Johnson ‘Correctly Interpreting Long-Term Leases Pursuant to Modern Contract Law: Towards a Theory of Relational Leases’ (1986) 74 *Virginia Law Review* 751.

⁵³ Or, as Lord Devlin put it, ‘the law might go further than it does towards meeting the business attitude’: ‘The Relation Between Commercial Law and Commercial Practice’ (1951) 14 *Modern Law Review* 249, 266. Lord Devlin laments that ‘although custom was the fount of the law merchant, it can no longer be regarded as a revivifying source of commercial law’ (251); similarly Hugh Beale and Tony Dugdale ‘Contracts Between Businessmen: Planning and the Use of Contractual Remedies’ (1975) 2 *British Journal of Law and Society* 45, 59 who found in their empirical study that ‘lawyers are thought not to understand the needs of commerce, with many respondents expressing more comfort with trade customs and ‘unwritten’ rules of contracting rather than formal legal conditions.

⁵⁴ S Todd Lowry ‘Lord Mansfield and the Law Merchant: Law and Economics in the Eighteenth Century’ (1973) 7(4) *Journal of Economic Issues* 605; J H Baker ‘The Law Merchant and the Common Law Before 1700’ (1979) 38(2) *Cambridge Law Journal* 295.

⁵⁵ ‘Common Law Obligations of Good Faith in Australian Commercial Contracts – A Relational Recipe’ (2005) 33 *Australian Business Law Review* 87.

⁵⁶ Marilyn Warren, Chief Justice of Victoria: ‘Good Faith: Where are We At?’ (2010) 34 *Melbourne University Law Review* 344, 356.

⁵⁷ This picks up the *Mackay v Dick* line of authority, to which reference was made earlier.

are reasonable having regard to the interests of the parties.⁵⁸ Courts have been somewhat reluctant to identify good faith, but have related good faith to concepts of reasonableness, contrasting it with the exercise of contractual power in a capricious or arbitrary way,⁵⁹ or in a manner contrary to the original purpose of the clause.⁶⁰ There are several American authorities that have found that a power to terminate the contract at will must be exercised in good faith.⁶¹ This has occurred, for instance, in the context of an employer having the authority to terminate an employment contract at will.⁶² The employer in such cases has a defence if there are sound business reasons for the dismissal.⁶³

4.0 Relief Against Forfeiture

It is submitted that our analysis here might be assisted by considering more generally the circumstances in which courts have been prepared to relieve against forfeiture of interests derived by contract. There is a well-established equitable jurisdiction allowing courts to provide relief against forfeiture of contractual interests, at least in some contexts.⁶⁴ A leading example is *Godfrey Constructions Pty Limited v Kanangra Park Pty Limited*.⁶⁵ There the contract allowed the vendor to rescind a contract of sale if they were unable or unwilling to

⁵⁸ Sir Anthony Mason 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66, 69. It is not clear whether 'reasonableness' is part of good faith or an ancillary requirement: see *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) NSWCA 187, where the Court spoke of an implied term of 'reasonableness and good faith' (573); Justice Steyn talks about 'reasonable commercial standards of fair dealing' ('Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *Law Quarterly Review* 433, 438); see recently *Network Ltd v Speck* [2009] VSC 235, *Australian Hotels Association (NSW) v TAB Ltd* [2006] NSWSC 293 and *Maitland Main Collieries Pty Ltd v Xstrata Mt Owen Pty Ltd* [2006] NSWSC 1235 for critique see John Carter and Elisabeth Peden 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155 who argue that good faith should be confined to 'honesty' and not reasonableness generally; they mean by 'honesty' not acting arbitrarily or capriciously, not acting with an intention to cause harm, and acting with due respect for the intent of the bargain as a matter of substance not form; to like effect Geoffrey Kuehne 'Implied Obligations of Good Faith and Reasonableness in the Performance of Contracts: Old Wine in New Bottles?' (2006) 33 *University of Western Australia Law Review* 63, 104-105 (Cf Robert Summers, who in 'Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code' (1968) 54(2) *Virginia Law Review* 195, 204 concludes that honesty is not an appropriate proxy for good faith, because it does not include acting capriciously, which is encompassed in the meaning of good faith; see also 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; 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. The *Uniform Commercial Code* is ambivalent here, s1-201 defining good faith in terms of honesty in fact in the conduct of the transaction, but s2-102 in the sale or goods article describing it as honesty in fact and reasonable standards of fair dealing. Allan Farnsworth concludes that the general good faith obligation means decency, fairness and reasonableness in performance or enforcement: 'Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code' (1963) 30 *University of Chicago Law Review* 666, 668.

⁵⁹ *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349, 368 (Sheller JA, with whom Powell and Beazley JJA agreed). John Carter and Elisabeth Peden, two leading authors in this field, agree that acting arbitrarily or capriciously is an example of a lack of good faith: 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155. Priestley JA in *Renard Constructions (ME) v Minister for Public Works* (1992) 26 NSWLR 234 asked whether the exercise of the principal's right of termination was 'reasonable' in applying the good faith concept (258), as did Handley JA (279-280, citing *Hillas and Co v Arcos Ltd* [1932] All ER 494, 507 for the proposition that the legal implication of reasonableness runs through contract law as applied to business).

⁶⁰ *Alcatel Australian Ltd v Scarcella* (1998) 44 NSWLR 349, 368 (Sheller JA, with whom Powell and Beazley JJA agreed).

⁶¹ *JR Watkins Co v Rich* 254 Mich. 82, 84-85, 235 NW 845, 846 (1931), *Busam Motor Sales v Ford Motor Co* 203 F 2d 469, 472 (6th Cir, 1953); Robert Summers 'Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code; (1968) 54(2) *Virginia Law Review* 195, 251-252; *Wallace v United Grain Growers Ltd* [1997] 3 S.C.R 701; Shannon Kathleen O'Byrne 'The Implied Term of Good Faith and Fair Dealing: Recent Developments' (2007) 86(2) *Canadian Bar Review* 194, 210-217.

⁶² *Fortune v National Cash Register Co* 364 NE (2d) 1251 (1977)(Court of Appeals, Massachusetts).

⁶³ *Stevenson v ITT Harper Inc* 51 Ill. App. 568, 366 NE 2d 561 (1977).

⁶⁴ In an early Australian case, Isaacs J found in *Gardiner v Orchard* (1910) 10 CLR 722, 739 that the vendor's rescission of the contract was required to be 'reasonable'.

⁶⁵ (1972) 128 CLR 529.

comply with an objection or requisition which the purchaser had made, and was unwilling to withdraw within 14 days of the vendor giving notice of their intention to rescind on this basis. The vendor purported to exercise this power when a purchaser did not withdraw a requisition they had made, after having been given notice under the section. The requisition related to the removal of a caveat filed by a previous purchaser of the property.

All members of the Court found that the purported rescission of the contract by the vendor was ineffective. Walsh J, with whom Gibbs J agreed, asked whether the vendor had exercised their rescission power in the contract 'arbitrarily or unreasonably'.⁶⁶ Stephen J agreed that the test of reasonableness must be applied in determining the validity of the vendor's purported rescission.⁶⁷ The same test was applied by the High Court in *Pierce Bell Sales Pty Limited v Frazer and Another*,⁶⁸ where the judges considered whether a similar power of rescission to that discussed in *Godfrey* had been exercised in a manner that was 'unreasonable and unconscionable'⁶⁹, or 'arbitrary, capricious or unreasonable'.⁷⁰ In the slightly different context where the purchase amount of rental premises depended partly on the extent to which the property was rented post-purchase, and where the purchaser had the right to determine whether the property was rented, the High Court found the purchaser could not exercise their discretion in an arbitrary or unreasonable way.⁷¹

An analogy may also be drawn in cases where equity has been prepared to intervene to protect against forfeiture of contractual interests. It must first be acknowledged here that the context is different – here the judges are discussing cases where one contracting party has terminated due to some breach of contract by the other party to the contract, and whether some limits should apply to their ability to do so (relief against forfeiture, particularly where proprietary interests are involved) or their ability to obtain compensation for the other's breach (specifically relief against penalties).

In one of the leading cases, *Shiloh Spinners Ltd v Harding*,⁷² the House of Lords confirmed the ability of courts to relieve against forfeiture, at least where the thing forfeited is proprietary interests. Many other cases confirm the same thing.⁷³ Less clear is equity's ability to relieve against forfeiture where what is forfeited is not proprietary rights, but forfeiture, in the case of the exercise of a termination for convenience clause, of the benefit of the remaining performance of the contract. In *Shiloh* itself, Lord Simon did not consider that the power to provide relief from forfeiture was limited to interference with proprietary rights, asserting that 'equity has an unlimited and unfettered jurisdiction to relieve against contractual forfeitures and penalties'.⁷⁴ His

⁶⁶ 543 (Walsh J), 547 (Gibbs J).

⁶⁷ 552 (citing *Page v Adam* (1841) 49 ER 342, 348 as an example of precedent in which the test of reasonableness was applied in reviewing the validity of the vendor's rescission). The other judges in *Godfrey* applied a test of 'unconscionability', reaching the same conclusion that the vendor's rescission was ineffective in the circumstances (Barwick CJ (538), with whom McTiernan J agreed (539)).

⁶⁸ (1973) 130 CLR 575

⁶⁹ 589 (Barwick CJ), with whom McTiernan J agreed (590); see also equivalent Canadian decisions such as *Mason v Freedman* [1958] S.C.R. 483, requiring that a vendor power to declare an agreement void be exercised reasonably and in good faith, and not in a capricious or arbitrary manner (para 6); *Le Mesurier v Andrus* (1986) 54 O.R. (2d) 1 (C.A.); Shannon Kathleen O'Byrne 'The Implied Term of Good Faith and Fair Dealing: Recent Developments' (2007) 86(2) *Canadian Bar Review* 193, 224-227.

⁷⁰ 591 (Gibbs J).

⁷¹ *Secured Income Real Estate (Australia) Limited v St Martins Investments Proprietary Limited* (1979) 144 CLR 596, 609 (Mason J, with whom all other justices agreed (Barwick CJ, Gibbs and Stephen JJ (599), Aickin J (615)). Similarly, relief against forfeiture may be appropriate where the party exercising it has contributed in some way to the other party's non-performance (*Legione v Hateley* (1983) 152 CLR 406, 449 (Mason and Deane JJ) or where the vendor, as a result of exercising such a power, would obtain a substantial windfall at the other party's expense (Gibbs CJ and Murphy J, 429)). Similarly, in the context of franchising agreements, a recent report expressed concern about opportunistic practices of some franchisors, before concluding that 'the optimal way to provide a deterrent against opportunistic conduct in the franchising sector is to explicitly incorporate ... the existing and widely accepted implied duty of parties to a franchising agreement to act in good faith': *Opportunity Not Opportunism: Improving Conduct in Australian Franchising* (2008) p114.

⁷² [1973] AC 691.

⁷³ For example, *Esanda Finance Corp Ltd v Plessing* (1989) 166 CLR 131; *Forestry Commission of New South Wales v Stefanetto* (1976) 133 CLR 507. One of the leading equity texts summarises the principles under the heading 'Forfeiture of Property': Roderick Meagher, Dyson Heydon and M Leeming *Equity: Doctrines and Remedies* (4th ed) 2002, p581-587.

⁷⁴ 726-727.

Lordship said that relevant factors in exercising the discretion would include how far it was 'reasonable' to expect the one purporting to forfeit the interest of the other to accept alternative remedies, how far enforcement of the contract would be grossly excessive and harsh given the breach, bearing in mind the damage done to the innocent party and the moral culpability of the wrongdoer, and the desirability that contractual rights are respected, and that flagrant and contemptuous breaches of contractual obligations not be encouraged.⁷⁵ Similar comments appear in some of the High Court of Australia judgments in *Legione v Hateley*.⁷⁶

Obviously Lord Simon in that case was discussing the case of forfeiture by one party after the other party breached the contract,⁷⁷ and sought to limit the right of the 'innocent party' to exercise forfeiture rights in such cases. In the different context where one party in exercising a termination for convenience clause does not rely on any breach of contract by the other party, one would have thought that Lord Simon would be more prepared to grant relief against such forfeiture. The rationale that flagrant and contemptuous breaches of contractual obligations not be encouraged obviously doesn't apply to such cases since there is no breach. It might also be considered quite reasonable for the party seeking to exercise such a remedy to have regard to alternative remedies – namely, the right to terminate the contract if there is a breach of condition by the other party. To most, this seems quite a reasonable circumstance in which termination might occur. If Lord Simon contemplates in *Shiloh* that forfeiture might be okay where to hold parties to a bargain that has been breached would be 'grossly excessive and harsh', he presumably would be more inclined to hold parties to a bargain where there was no breach at all.

As indicated above, the discussion regarding 'relief against forfeiture' tends to occur in the context of forfeiture of proprietary interests. There is uncertainty regarding whether 'relief against forfeiture' could extend to non-proprietary interests. The High Court expressly left open the question in *Sunbird Plaza Pty Ltd v Maloney*.⁷⁸ With respect, given that the court's ability to provide relief under the doctrine of unconscionability⁷⁹

⁷⁵ 726-727

⁷⁶ (1983) 152 CLR 406, 429 (Gibbs CJ, Murphy) referring to a windfall to the party seeking to exert forfeiture and the gravity of the other party's breach as relevant factors, and 449 (Mason and Deane JJ) referring to the vendor having contributed to the other party's breach and of having unconscientiously taken advantage of a situation in order to secure a windfall gain, rather than to preserve legitimate interests or protect themselves against loss. Division has emerged in later cases as to whether equity's intervention is confined to cases where the behaviour of the party wishing to rescind for the other's breach meets the definition of unconscionable or unconscientious behaviour (yes, according to Mason CJ and Brennan J (dissenting) in *Stern v McArthur* (1988) 165 CLR 489, 503 and 520, and Gleeson CJ McHugh Gummow Hayne and Heydon JJ in *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, 335 (Kirby J similar at 345 and Callinan J at 363); no, according to Deane and Dawson JJ in *Stern*, 527-528. The Privy Council in *Union Eagle Limited v Golden Achievement Limited (Hong Kong)* [1997] UKPC 5, para 8 expressed concern that use of the concept 'unconscionability' here could create uncertainty.

⁷⁷ The author concedes it can be dangerous to interpret and apply words used in one context in a different context.

⁷⁸ (1988) 166 CLR 245, 263 (Mason CJ): 'there may be other situations (ie other than those involving loss of a proprietary interest) in which the breach of a term expressed to be an essential condition is so trivial and insignificant that an attempt to take advantage of it for the purpose of terminating the contract would violate the dictates of fair dealing or would amount to unconscionable or inequitable conduct and give rise to a case for relief' (with whom Deane Dawson and Toohey JJ agreed); 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.

⁷⁹ Readers may wonder why I have not argued that termination for convenience clauses be challenged on the basis of the principle of unconscionability. I have considered this, but the law of unconscionability at present is not easily applied to the exercise of a 'termination for convenience' clause. For instance, unconscionability generally requires that one of the parties be at a 'special disadvantage', typically meaning illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affecting their ability to conserve their own interests (*Commercial Bank of Australia v Amadio* (1983) 151 CLR 447). It is not easy to argue that a commercial party that signed a contract containing a termination for convenience clause is at such a 'special disadvantage'. Further, most of the cases where the doctrine has been applied have involved questions of unconscionable behaviour in the formation of the contract, rather than in the substantive terms (P O'Shea 'All's Fair in Love and War – But Not Contract' (2004) 23(1) *University of Queensland Law Journal* 226, 231; J Davidson 'Unfair Contract Terms and the Consumer: A Case for Proactive Regulation?' (2007) 15 *Competition and Consumer Law Journal* 74; S Smith 'In Defence of Substantive Fairness' (1996) 112 *Law Quarterly Review* 138. This philosophy has also been extended into the consumer protection statutes: see for instance the Full Court in *Hurley v McDonald's Australia Ltd* (2000) ATPR 41-741, 29-31: 'before s51AA, AB or AC (as they then were, in the *Trade Practices Act 1974* (Cth), see now s21-23 of the *Australian Consumer Law 2010* (Cth), will be applicable, there must be some circumstances other than the mere

is not limited to the protection of proprietary interests, there seems little justification for insisting that the court's ability to provide relief against forfeiture be limited to forfeiture of property interests.

There is limited precedent where the court has considered the precise question as to whether the exercise of a termination for convenience power is conditioned by the principle of good faith. Most of the cases have involved termination in the context of default (or alleged default) by the other party, including *Renard*, *Burger King*, *Alcatel* and *Garry Rogers Motors*. However, in dicta in some of these cases, the court has found that, particularly where the power of termination is a 'general one' (which is taken to imply a termination for any reason whatsoever, or in other words termination for convenience), it is even more likely that a requirement of good faith will be imposed on such exercise. This appears in the decision of the Court of Appeal in *Burger King*⁸⁰ and the judgment of Finkelstein in *Garry Rogers Motors*.⁸¹ Dicta comments of Finn J in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* suggest that the exercise of a termination for convenience power will be subject to the requirements of good faith.⁸² The Chief Justice of Victoria has noted extra-judicially that the use of a termination for convenience clause is 'often' characterised as not being an exercise of good faith.⁸³ In a couple of recent interlocutory proceedings, the matter was again considered, with Davies J in *Sundararajah v Teachers' Federation Health Ltd* accepting that a broad termination power could be circumscribed by implications such as good faith, particularly where the power was one-sided only⁸⁴ (as they usually are).

5. Does the Reason for the Termination Matter?

Finally, the fact that there may be different reasons for the exercise of the termination for convenience clause should be considered. In my discussions with industry, three main reasons have been provided as to why a party might wish to include, or to exercise, a termination for convenience clause in their contract with another:

- (a) That, in the case of a head contractor, they need the clause to be included in their contracts with sub-contractors, because it is a term of the contract between the client and the head contractor (ie a back to back arrangement);
- (b) That it is necessary to deal with unforeseen events, such as something like the global financial crisis; and
- (c) They might, after having awarded a contract to one contractor, find a 'better' option while that contract remains on-foot, such as another contractor who would meet the required quality of work, but at a cheaper price, and the termination for convenience clause is needed to take advantage of such opportunities.

The application of the above principles will now be applied to each of these situations.

(emphasis added) terms of the contract itself that would render reliance on the terms of the contract 'unfair' or 'unreasonable' or 'immoral' or 'wrong'; to like effect Nicholson J in *Australian Competition and Consumer Commission v Lux Pty Ltd* [2004] FCA 926, [94], 'to ground a finding of contravention of s51AB, there must be some circumstance other than the mere terms of the contract itself which renders reliance on the terms of the contract unconscionable'. Elisabeth Peden has drawn the same conclusion, finding that 'unconscionability' is more difficult to establish than a breach of good faith obligation (or, if it be different, a requirement of reasonableness): 'When Common Law Trumps Equity: The Rise of Good Faith and Reasonableness and the Demise of Unconscionability' (2005) 21 *Journal of Contract Law* 226.

⁸⁰ 569 (Sheller JA, Beazley and Stein JA).

⁸¹ Para 35.

⁸² (2003) 128 FCR 1, 173-174; see also Windeyer J in *Apple Communications Ltd v Optus Mobile Pty Ltd* [2001] NSWSC 635.

⁸³ Warren CJ 'Good Faith: Where are We At?' (2010) 34 *Melbourne University Law Review* 344, 356.

⁸⁴ [2009] NSWSC 1443, [31], with which Cowdroy J agreed: *NA Retail Solutions Pty Ltd v St George Bank Limited* [2010] FCA 290; see also Hansen J in *Kellogg Brown and Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200; cf *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 130.

(a) The Back to Back Scenario

This would allow a head contractor to terminate for convenience a contract with a subcontractor, because the client exercised a terminate for convenience clause with the head contractor. The author sees justification for the

use of such a clause in such cases. Assuming that the good faith obligation applies, and of course depending on which definition is chosen, a head contractor exercising such an option is acting honestly. Most people would find an exercise of such a power in cases like this to be 'reasonable', since otherwise the head contractor would be liable for obligations on contracts whose performance is now superfluous, given the actions of the client. The exercise of a termination for convenience clause here would not be arbitrary or capricious; it would not be exercised for reasons other than those for which it was conferred. The head contractor would not be making a windfall gain.

This conclusion is subject to two caveats. Firstly, that no action of the head contractor caused the client to exercise its termination for convenience clause, since if in fact the termination of the head contract was for cause, questions might arise in such cases as to whether the head contractor should, in effect, be allowed to rely on their own wrongdoing to cancel contracts with their sub-contractors. Secondly, that the termination for convenience clause contain 'appropriate' compensation for the work carried out by the sub-contractor, or expense incurred by the sub-contractor and not refundable, prior to the date of termination.⁸⁵ If this limit did not apply, the possibility would exist that the party exercising such a clause could get the benefit of a windfall gain, particularly if the work done had been 'encompassed' in the project. As long as the requirement applied to the head contract, it would need to apply to any sub-contracts as well, since if it applied to the head contract but not the sub-contract, again the possibility of windfall gain arises, and the clause might then be used to achieve purposes other than those for which the power was conferred.⁸⁶

(b) GFC-Type Events

Sometimes, one party to a contract might wish to exercise a termination for convenience right because their financial circumstances have changed for reasons beyond their control. For instance, this affected many contracts around the time of the (first?) global financial crisis in 2008, where world events made finance more difficult to obtain than expected, placing some projects in jeopardy. If so, would this be an exercise of a termination for convenience power in good faith?

If such events did occur, it would hard to argue that the party terminating because of a real change in their financial circumstances was not acting 'honestly', if that is all that good faith requires. However, the party should not be seen to be acting capriciously, in purporting to terminate based on such events, where the evidence does not in fact disclose that the GFC has in fact impacted on them, or is likely to do so. In other words, there would need to be evidence that the claims made were genuine. Some analogy may be drawn here with cases in which courts have exercised clauses in contracts making performance 'subject to finance'. While space restrictions preclude a detailed analysis of such cases, in a leading High Court decision in the field, *Meehan v Jones*,⁸⁷ two judges suggested that the exercise of the purchaser's power to rescind the contract if they don't find finance satisfactory to them may be accompanied by obligation of reasonableness.⁸⁸ Similarly here, while it would typically be justified for a contracting party to exercise a termination for convenience clause because of

⁸⁵ This requirement would also be applicable to the exercise by the client of a termination for convenience clause in their contract with the head contractor.

⁸⁶ This conclusion is not inconsistent with my comparison earlier to the insurance context, stating that good faith is a particularly important obligation when facts are not known to one party, but are to the other party. In the context of a 'back to back' termination for convenience, the 'facts' (ie the risk that the head contract, and subsequently sub-contracts will be prematurely terminated) are unknown to either party.

⁸⁷ (1982) 149 CLR 571

⁸⁸ Mason J discussed the purchaser's obligation 'to act honestly, or honestly and reasonably' (588); Wilson J stated the purchaser was required to make 'reasonable efforts' (598); cf Gibbs CJ, who confined the obligation to one of honesty only (581), and Murphy J, who denied any such obligation at all (597).

fundamental economic or financial changes,⁸⁹ the power should not be used capriciously or arbitrarily *i.e.* should not be used when the party in fact does not have a legitimate concern about finances, and they are seeking to avoid contractual obligations for other business reasons, or where they do have concerns about finances but they are unrealistic or overblown.

(c) The Party Exercising the Power Has Just Found a Better Option

Assume that after awarding a contract to a contractor, and while that contract remains on foot, the client discovers a better option, for instance they have found another contractor able to do the work at the required quality level, but for a substantially cheaper price. Should the client be entitled to exercise a termination for convenience clause in the original contract, in order to take advantage of the better option now presenting itself?

This is arguably the type of context where a good faith requirement could be of particular use. The author would argue that the termination for convenience power should be tempered by a requirement of good faith, and that the exercise of a termination power in these circumstances would not be consistent with good faith. It would be an arbitrary and capricious exercise of the power, acting in a way contrary to the spirit of the underlying bargain between the original contracting parties. In the author's view, this action would not be reasonable, though it may, according to my definition, be 'honest' behaviour. However, unless good faith is applied to the contract, it would be hard for other legal doctrines to forbid this exercise of discretion – it would not be considered 'unconscionable', at least according to the current formulation of such a concept, to mean where one party is at a special disadvantage, it is not a breach of fiduciary duty, no question of estoppel or misleading or deceptive conduct arises. It is not contrary to the *Mackay v Dick* line of cases. However, cases such as *Legione v Hately*, *Godrey*, *Pierce Bell and Shiloh Spinners* may be useful, including considerations of whether the party exercising a power of rescission (albeit in different contexts in those cases) would thereby obtain a windfall gain. It might be argued that exercising a termination for convenience clause purely to engage a cheaper contractor might involve a windfall gain to the party wishing to do so.

In *Carr v JA Berriman Pty Ltd*⁹⁰ the High Court was faced with facts like these. There a clause in a building contract allowed an architect in their absolute discretion to give a contractor notice not to do particular work. The architect purported to exercise the power, giving the contractor notice not to do particular work, but then engaging another to do the work. The High Court found this conduct was not authorised by the apparently very wide language of the 'absolute discretion' found in the contract.⁹¹ Fullagar J, with whom all other judges agreed, found that 'a power in the architect to hand over at will any part of the contract to another contractor would be a most unreasonable power'.⁹² Commenting on the architect's actions, Fullagar J said

A reasonable man could hardly draw any other inference than that the building owner does not intend to take the contract seriously, that he is prepared to carry out his part of the contract only if and when it suits him.⁹³

Clearly, the High Court in this case did not approve of such actions on the part of one party to a contract. In a case today, the author suggests that, similarly, the High Court should not allow one party to exercise a termination for convenience clause merely in order to substitute one contractor with another for reasons of price etc. Allowing this behaviour would encourage parties, in the words of the High Court in *Carr*, to 'not take their contracts seriously'.

⁸⁹ Again, this is not considered inconsistent with my comparison earlier with the insurance context, stating that good faith is particularly important when facts are not known to one party but are to the other. Something like a GFC is not within the knowledge of party but not the other.

⁹⁰ (1953) 89 CLR 327.

⁹¹ It is true that the judges found that such a termination at will might be okay if 'very clear words' were used to convey that this was the parties' intention (347); however with respect, the words of the contract there were very broad, conferring the architect with 'absolute discretion' to direct changes in scope of work, yet these very broad words were, in the author's view, read down to not include an exercise of which the High Court expressed discomfort.

⁹² 347.

⁹³ 351.

6. Conclusion

This paper has considered the increasing use of termination for convenience clauses in contracts. In that context, it has considered the contested concept of 'good faith' and the extent to which such an obligation does or should apply to a contract. It has been argued that the concept should include an obligation not to act unreasonably and/or arbitrarily, and that the exercise of a termination for convenience power does, in some cases, breach the obligation of good faith. Far from creating uncertainty and undermining parties' bargains, recognition of good faith reflects the actual expectations of contracting parties, and there is much sense, as well as history, in having the actual expectations and attitudes of contracting parties reflected in, and not contradicted by, the legal rules of contracting.⁹⁴

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⁹⁴ Interestingly, of the many parties to contracts which the author has spoken to regarding rights to terminate for convenience, most have agreed that termination for convenience in the back to back context, and for GFC type events, is in their minds a reasonable exercise, but generally the view is that a party should not be able to exercise such a right merely because they have found a cheaper contracting option. If the legal approach I favour on this issue were adopted then, it would be consistent with the general (though of course not universal) expectations of contracting parties.