CURRENT ISSUES IN THE TERMINATION OF CONSTRUCTION CONTRACTS

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1. INTRODUCTION

When a client approaches his or her lawyer seeking advice on how to terminate a contract before completion of the contract term, there is a series of warning bells which sound in the lawyer's mind. The reason for this is that unless there is agreement amongst the parties to the contract to bring the contract to an end, there will often be substantial risks in the course the client is seeking to adopt. The fact that the contract is a construction contract, be it, for example, a design and construct contract, engineering, procurement and construction contract or a joint venture agreement, in most cases does not impact on the contracting parties' legal rights to terminate; it may, however, impact on practical considerations which need to be taken into account before the termination occurs.

There are several well established bases on which a party can terminate a contract. First, as mentioned above, the parties can by agreement bring the contract to an end. Secondly, the termination may arise out of a breach by one party of a condition or fundamental term of the contract. Thirdly, the termination might come about through the enforcement by one party of a term of the contract which empowers that party to terminate in certain circumstances. It is beyond the scope of this article to examine in detail all the bases upon which termination rights may arise. The objective of this paper is, therefore, to consider, in the light of recent Australian authorities, two aspects of the termination of contracts which are particularly relevant to construction contracts. These are the doctrine of election and the concept of termination for convenience. The latter, in particular, has been the subject of debate in various Australian jurisdictions and amongst legal commentators in recent times.

2. ELECTION

2.1 What is election and when does it arise?

The doctrine of election involves a choice by a party to a contract between two inconsistent rights. For the purposes of this article, these inconsistent rights

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are the right to continue with the contract and the right to terminate the contract. The need for an election comes about through a breach by one of the parties of a condition, breach of a fundamental term of the contract, repudiation,[1] or by the occurrence of a certain event or the non-fulfilment of a certain condition contained in the contract between the parties.

In practice, the doctrine becomes important where the "non-electing party" wishes to prove that the other party has in fact elected either to continue with or terminate the contract. Alternatively, a party may allege that an "election" was wrongful and therefore equates to a repudiation; this scenario can reverse the initial situation. The doctrine of election has been the subject of many cases and much legal commentary.

The issues relating to election and waiver of the right to terminate are general contractual issues. They are not unique in any way to construction contracts. Many of the authoritative decisions in this area concern contracts for the sale of land. However, election can be extremely important in relation to development contracts or joint venture agreements where a party wishes to terminate the contractual arrangements.

The right to terminate in these cases often arises out of an express term of the contract (rather than as a result of a breach under the contract). It may involve, for example, the inability of the parties to obtain the approval of the Foreign Investment Review Board[2] (in spite of the parties having made all reasonable efforts to do so) or the failure by one party to obtain a planning permit for the proposed project.

In some cases, the right arises well before legal advice is obtained by the party. This delay gives rise to the question of whether the party who seeks to terminate the contract has either affirmed the contract and thereby waived its right to terminate or whether the right has been extinguished by the effluxion of time. The affirmation may comprise a series of acts put together (*Christiansen* v. *Klepac*[3]).

The doctrine of estoppel is closely aligned with election and waiver. This doctrine operates to prevent a person who has relied on an assumption as to a present, past or future state of affairs, which assumption the other party has induced him to hold, from suffering detriment in reliance on the assumption as a result of denial of its correctness (see *Commonwealth* v. *Verwayen*[4]). It should be noted, however, that the prevailing view in the Australian courts is that whilst detriment is an essential element of estoppel, it is not so in relation to election and waiver.

[1] See: J W Carter, "Failure to Perform as 'Acceptance' of a Repudiation" (1997) 11 *Journal of Contract Law* 255; and *Vitol SA* v. *Norelf Ltd* [1996] 3 WLR 105.

[2] The Foreign Investment Review Board is a non-statutory body established in April 1976 to advise the Australian Government on foreign investment policy and its administration.

[3] (2001) 10 BPR 18,955; [2001] NSWSC 385.

[4] (1990) 170 CLR 394, *per* Mason CJ at 413.

2.2 The required elements for lawful election

A number of recent Australian cases have looked at the requirements for a successful election. These follow two key High Court cases which established the general parameters of the doctrine of election: *Sargent* v. *ASL Developments Ltd*[5] and *Immer (No 145) Pty Ltd* v. *Uniting Church in Australia Property Trust (NSW)*.[6]

Sargent v. ASL Developments Ltd

Sargent is one of the leading Australian cases on the issue of election. It provides a comprehensive analysis of the doctrine as at the date of the judgment.

The dispute in *Sargent* concerned a contract of sale which contained a right to rescind if it were established prior to completion of the contract that at the date of the contract the property was affected by a planning scheme other than as stated in the schedule to the contract. The contract stated that the property was affected as shown in a certificate annexed to the contract. There was no certificate attached to the contract.

The first issue before the court was the construction of the standard form contract. The court held that since there was no certificate annexed to the contract, a right to rescind was conferred on the vendors.

The court then considered whether the vendors had elected to proceed with the contract given their conduct following execution of the contract. The vendors or their solicitors had known at the date of the contract that the property was affected by planning schemes. The vendors did not act on their right to rescind until 32 months after the right first arose.

Stephen J, who wrote the leading judgment, examined the current state of the law on election. He observed (footnotes omitted):

> "The words or conduct ordinarily required to constitute an election must be unequivocal in the sense that it is consistent only with the exercise of one of the two sets of rights and inconsistent with the exercise of the other; . . . However, less unequivocal conduct, only providing some evidence of an election, may suffice if coupled with actual knowledge of the right of election (*Elder's Trustee Case*). There need be no expressed intention to elect, nor will an express disclaimer of such an intention be of any avail in preserving one right if in fact there be an exercise of another inconsistent right (*Croft* v. *Lumley*; *Matthews* v. *Smallwood*). For an election there need be no actual, subjective intention to elect (*Scarf* v. *Jardine*), an election is the effect which the law attributes to conduct justifiable only if such an election had been made (*per* Kitto J in *Tropical Traders Ltd* v. *Goonan*; *cf. S Kaprow & Co Ltd* v. *Maclelland & Co Ltd*, *per* Wrottesley LJ)".[7]

An important issue addressed by Stephen J was the level of knowledge required by the party who has the right to make the election. After noting that

[5] (1974) 131 CLR 634.
[6] (1993) 182 CLR 26.
[7] (1974) 131 CLR 634 at 646.

the case law to date had been largely inconsistent, Stephen J concluded that the best interpretation was that the level of knowledge depends on the type of right. Where the right to elect is conferred by an express contractual provision, the party only needs knowledge that the relevant situation has occurred; otherwise both knowledge of the legal right and knowledge that the facts have occurred is required. Stephen J concluded: "[w]here election is in question between contracting parties and, in these appeals, the contract itself confers the inconsistent rights there can be no question whether a party had knowledge of his choice of rights. He is deemed to know the terms of his own contract and the rights it confers."[8]

Stephen J also noted the divergence of views on the question of whether detriment was an essential element of election. He concluded that the view of the High Court was that detriment was not a necessary element and that this distinguished election from the related doctrine of estoppel.

Mason J considered the question of delay in exercising a right to rescind, stating that: "[a] person confronted with a choice between the exercise of alternative and inconsistent rights is not bound to elect at once. He may keep the question open, so long as he does not affirm the contract or continuance of the estate and so long as the delay does not cause prejudice to the other side."[9]

Based on the analyses undertaken by Stephen and Mason JJ, the court held that two of the vendors, knowing of the planning scheme which affected the property from the date of the contract of sale, had acted unequivocally to affirm the contracts by receiving quarterly interest payments from the purchasers over 32 months and were thereby precluded from relying on the right to rescind under their contracts. The result was similar for the remaining vendor, who had also been aware of the planning scheme and who, through its solicitor, had both executed a form of application to bring the land under the Real Property Act (NSW) and received instalment payments over an extended period.

The key principle demonstrated in *Sargent* is that there does not have to be an express intention to "elect" between two inconsistent rights; it is sufficient if there is conduct which is only justifiable if an election has been made. Once a right arises it is not necessary to elect immediately—as long as the relevant party does not conduct itself in a manner which will constitute "unequivocal conduct".

With regard to knowledge, *Sargent* makes it clear that, where the right occurs as a result of an express provision of the contract, a court will deem the party to have knowledge of the legal right; in this case all that needs to be shown is knowledge of the facts which trigger the right.

Finally, detriment is not an essential element of election.

It is important to remember that in many ways *Sargent* simply draws the

[8] *Ibid.* at 645.
[9] *Ibid.* at 656.

outline of the doctrine. Later cases have developed the doctrine, and help explain how the approach set out in *Sargent* actually works in practice.

The principles stated in *Sargent* were applied by the High Court in *Khoury* v. *Government Insurance Office of New South Wales*.[10] That case involved an insurance contract and an insured party who had failed to comply with its obligations of disclosure to the insurer. The court held that the lack of disclosure by the insured party meant that the insurer had not elected between its rights: the lack of disclosure meant that the insurer did not have the requisite knowledge of the inconsistent rights.

Immer (No 145) Pty Ltd v. Uniting Church in Australia Property Trust (NSW)

Two decades after *Sargent*, the High Court of Australia again considered the doctrine of election in the case of *Immer (No 145) Pty Ltd* v. *Uniting Church in Australia Property Trust (NSW)*.[11]

Immer purchased "transferable floor space" from the Uniting Church. The deed provided that Immer was entitled to rescind the contract if the Sydney City Council did not grant certain approvals before 1 April 1989. On 26 June 1989 Immer's solicitors forwarded a deed of assignment which contained a recital stating that approval had been granted, when in fact the approval was being withheld pending restoration work on the Uniting Church's property. When Immer learnt that the approval was being withheld, it gave notice of rescission on 25 August 1989. The Supreme Court of New South Wales held that Immer had lost its right to rescind. Immer appealed.

The majority judgment in the High Court appeal identified the issue in this case as not simply: "whether the conduct of Immer, viewed objectively, constituted an election not to exercise its contractual right of rescission. Rather, the question as argued is whether, in the light of Immer's knowledge or lack of knowledge of relevant circumstances, it can be held to have so elected."[12]

The court continued:

> "But in a case such as the present one, the choice is not merely one of affirming the agreement; it involves as well the abandonment of the right to rescind. Abandonment is more readily inferred in some circumstances, for instance where the choice arises once and for all. Here, by reason of cl. 7 of the deed, Immer was entitled at any time after 1 April 1989 to rescind the deed. . . . The point is that where the right to rescind is a continuing one, it is not so readily concluded that the party entitled to rescind has abandoned that right completely as opposed to taking no action to exercise the right at the time in question."[13]

The court allowed the appeal, finding that Immer had not elected to affirm the contract. The court held that the letter of 26 June 1989 and Immer's

[10] (1983) 165 CLR 622.
[11] (1993) 182 CLR 26.
[12] *Ibid*, at 38.
[13] *Ibid*, at 42.

actions at that time were consistent with Immer being prepared to continue with an agreement which it understood to be ready for completion and because of which it did not direct attention to its rights under clause 7 of the deed. The court held further that the Uniting Church had not suffered any prejudice as a result of Immer's actions.

In addition to emphasising that an unequivocal act is required, the decision in *Immer* clarifies the situation in relation to a continuing right of rescission. Where a right to terminate or rescind is continuing, a party will generally need to show conduct which amounts to more than simply inaction, in order to make out an argument that the contract has been brought to an end.

It has been noted, though, that the judgment in *Immer* missed the opportunity to clarify some issues that have remained undecided by the High Court.[14] First, despite Immer making an election based on a mistake, the High Court managed to decide the case without reference to the mistake. It is therefore still unclear what effect "mistake" will have on an election. Further, the joint judgment in *Immer* merely refers to a distinction between the different types of knowledge of a right to rescind without establishing what type of knowledge is actually required for an election to be made out. The issues in relation to knowledge will be discussed further below.

2.3 Knowledge required for election

Because a key element of election is the existence of incompatible rights, an issue that can become extremely relevant in deciding whether an election has occurred is "knowledge" of those rights. The judgment of Stephen J in *Sargent* identified a variety of conflicting authorities in relation to the level of knowledge required. In an effort to reconcile the case law, Stephen J held that where the right arises pursuant to an express contractual term, the party is deemed to have knowledge of the legal right therefore the only knowledge required is that of the relevant facts. Despite not stating it decisively the judgment implies that where the right arises under anything but an express contractual term, knowledge of both the legal right and the relevant facts is required. No other High Court case has decided the issue definitively. However, the Full Court of the Tasmanian Supreme Court revisited the issue of knowledge in *J Boag and Son Brewing Ltd* v. *Bridon Investments Pty Ltd*[15] and in doing so, applied the distinction made by Stephen J in *Sargent*.

J Boag & Son Brewing Ltd v. Bridon Investments Pty Ltd

J Boag & Son Brewing concerned a contract of sale for a hotel in Burnie, Tasmania. The contract contained a condition precedent concerning

[14] Diane Skapinker, "Election and Continuing Rights of Rescission" (1994) 7(1) *Journal of Contract Law* 86 at 89.

[15] [1999] TASSC 118.

finance which condition was not satisfied within the time specified in the contract. At first instance, the trial judge held, amongst other things, that the purchaser had not waived the operation of the condition. On appeal, it was argued that there were no grounds upon which to base this finding. The appeal was allowed.

The Full Court relied on *Sargent* and on *Commonwealth* v. *Verwayen*[16] for guidance on the doctrines of waiver and election.

One of the issues before the court was the question of the extent of knowledge necessary in order to make an effective and binding election. The trial judge had held that there could be no waiver of a condition precedent unless the respondents (being the purchaser) knew at the relevant time that the condition precedent was not satisfied.

The Full Court stated, relying on *Sargent* (amongst others), that "[k]nowledge of the relevant facts by the party seeking to make the election is an essential element in the doctrine".[17] However, the court then considered whether it was necessary to have knowledge of the facts that give rise to the right to make the election and knowledge of the existence of the legal right arising from those facts, or simply the former. The court applied the distinction made by Stephen J in *Sargent* between an express contractual right and other rights:

> "on 19 February 1997 the respondents, by their agent, Miss Nguyen, knew the facts that gave them the right to either rescind the contract or proceed with it. These facts were all that at the expiry of the time prescribed for the fulfilment of cl. 5.2(b), finance had not been approved in accordance with the terms of that clause. No additional fact was necessary in order to give rise to the inconsistent rights."[18]

Consequently, the court held that a telephone conversation from the respondents' agent to the appellants' agent on 21 February 1997 was therefore "not open to any construction other than that the respondents will proceed with the contract"; it therefore constituted an effective election.[19] For a different fact situation, where the court held that there was inadequate knowledge, see the brief discussion of *Khoury*, above, page 492.

Observations

To date, the High Court authority in relation to "knowledge" suggests that there is a distinction between a right arising from an express contractual term and other rights.

If the right is an express contractual term it will be deemed that there is knowledge of the legal right; all that must be shown is that the party knew that the relevant facts had occurred. Conversely, it appears that the court will

[16] (1990) 170 CLR 394.
[17] [1999] TASSC 118 at para. 28.
[18] *Ibid.* at para. 34.
[19] *Ibid.* at para. 35.

require both knowledge of the legal right and knowledge that the facts have occurred before an election can be made out.

Unfortunately the practical application of this distinction by the courts seems to be more problematic and far less certain than it might seem in theory.

As practitioners who specialise in construction and engineering contracts are aware, all too often the parties to these contracts are guilty of failing to inform themselves properly of their rights contained in their contract. In many cases, the contract is in fact signed after work begins and issues such as the scope of the work and the allocation of risk are the primary focus of the parties at that stage. This can result in significant risks for the parties should a right to terminate arise under the contract; by continuing to work under the contract, it is possible that a party will affirm the contract without ever having turned its mind to whether election to terminate may have provided a better outcome.

2.4 Conduct

The decision in *Sargent* made it clear that an election can only be made by "unequivocal" conduct. As with many judicial pronouncements, defining this "test" can be just as difficult as interpreting the doctrine in the first place. It can be seen from the judgment in *Immer* that different types of rights will lead to a different definition of what "unequivocal" conduct is. In *Immer*, the right of rescission was a continuing one; mere silence or inaction was inadequate to suggest that the contract was being affirmed.

A more recent example of the importance of defining what the relevant conduct is and whether it constitutes "unequivocal" conduct can be found in *Cohen* v. *Dowd*.[20]

Cohen v. Dowd

The Full Court of the Supreme Court of Tasmania applied the *Sargent* case in determining *Cohen* v. *Dowd*. This case concerned a contract for the sale of land, however the issue came before the court as a claim for negligence against the defendant firm of solicitors. Mr and Mrs Cohen entered into two contracts. The first contract was for the sale of their property to Mr How. The second was for the purchase of a new property which was being completed by an owner/builder, Mr Berry. It was agreed that the settlement of both contracts would be 5 December 1994, however, the contract between the Cohens and Mr Berry contained a clause stating that the agreement was subject to and conditional upon the Cohens "effecting a contemporaneous settlement of their unconditional sale" of their property to Mr How by

[20] [2000] TASSC 174.

4 December 1994. The Cohens arranged with Mr Berry to move into their new house over the weekend of 3 December. Mr How did not complete his contract with the Cohens on 5 December.

The trial judge had found that if the Cohens had known on 12 January 1995 that they could have rescinded the contract for Mr Berry's house and returned to their original property, they would have done so. However, as a result of advice from their solicitors, they had arranged bridging finance and completed the purchase, thus losing substantial money. The trial judge also found that by moving into the new house and remaining there through December and early January, the Cohens had engaged in unequivocal conduct showing an election to proceed with the contract.

The Full Court did not agree with this finding. A relevant fact was that the Cohens had moved into the new house before the date on which they would have become entitled to rescind the contract with Mr Berry. A second relevant fact was that they had instructed their solicitors to write to Mr Berry advising that the condition had not been fulfilled. Cox CJ said:

> "By doing so they were, in my view, purporting to keep their options open and were not committing themselves to an affirmation of the contract. They were not entitled to keep the question open if the delay caused prejudice to the other side (*Sargent* v. *ASL Developments Ltd* (*supra*) at 656), but there is nothing in the evidence which suggests that Mr Berry was occasioned any particular prejudice by the appellants' delay between 5 December and 12 January."[21]

Crawford J also took into account the fact that the Cohens paid Mr Berry rent during their occupation of the new house which demonstrated that they were not in the house pursuant to the contract of sale and the fact that Mr Berry had given a notice to complete, indicating that he had a right to terminate the contract once the date specified in the notice had expired.

2.5 Delay

An issue which is aligned to the "conduct" element is timing of the events alleged to constitute an election. The implications of delay have been discussed in two recent Supreme Court cases: *Christiansen* v. *Klepac*[22] and *Georges France Photography Pty Ltd* v. *M & T Zimmerman Pty Ltd*.[23]

Christiansen v. Klepac

Christiansen v. *Klepac* concerned a contract for the sale of a unit, dated 8 July 1998. This contract provided that if the necessary strata plan had not been registered within 12 months of the date of the contract, both the purchaser and the vendor (provided it had done "everything reasonable to have the plan registered") had the right to terminate the contract. The plan was not

[21] *Ibid.* at para. 10.
[22] [2001] NSWSC 385.
[23] [2001] WASC 220.

registered within the 12-month period and the vendor purported to rescind the contract by a notice dated 29 September 1999. The question for the court was whether events which had occurred between 9 July and 29 September 1999 precluded the vendor through the operation of the doctrines of waiver, election or estoppel, from rescinding the contract. These events included the installation of items which were extras under the contract. The defendant (being the vendor) claimed that he had been entitled to do acts which were consistent with the contract while he made up his mind whether or not to affirm or rescind the contract.

Young J made the following statements:

> "The authorities are clear that the conduct that must be proved by a plaintiff to establish election (sometimes called waiver) 'must be unequivocal in the true sense of the word'. The conduct must be capable of one construction only, namely, that X has chosen to forgo its rights: Wilkin and Villiers, *Waiver Variation and Estoppel* (John Wiley & Sons, Chichester, 1998), p. 48. That succinctly states the law. More authoritative, but longer, statements to much the same effect come from the leading cases of *Tropical Traders Ltd* v. *Goonan* (1964) 111 CLR 41, 55; *Sargent* v. *ASL Developments Pty Ltd* (1974) 131 CLR 634 and *Immer (No 145) Pty Ltd* v. *Uniting Church in Australia Property Trust (NSW)* (1993) 182 CLR 26.[24]
>
> ... It is clear that a person has a reasonable time to make up his or her mind as to whether to exercise the right of rescission so long as that person does nothing to affirm the contract and so long as the respondent's position is not prejudiced by delay: *Tropical Traders* at p 55."[25]

Young J added that "the mere fact that a person does an act, which he or she does because the contract is on foot, does not necessarily amount to an election to keep the contract on foot".[26]

Young J found that there was no detriment suffered by the purchaser because of the vendor's delay in giving notice of rescission and that "on the whole of the balance of the evidence" there was no election to affirm the contract.[27]

Georges France Photography Pty Ltd v. M & T Zimmerman Pty Ltd

In the case of *Georges France Photography Pty Ltd* v. *M & T Zimmerman Pty Ltd*[28] the court was asked to determine whether the plaintiff ("GFC") was entitled to terminate its production agreement with the defendants (the "Zimmerman companies") as a result of a breach by the Zimmerman companies of a contractual requirement to use Kodak paper for processing GFC film. This case demonstrates how an election can be validly made some time after the right to terminate arises without the party seeking to terminate having waived its entitlement.

Anderson J found that the contractual breach by the Zimmerman

[24] [2001] NSWSC 385 at para. 18.
[25] *Ibid.* at para. 19.
[26] *Ibid.* at para. 20.
[27] *Ibid.* at para. 30.
[28] [2001] WASC 220.

companies had occurred over a period greater than six months and that although GFC had given approval for limited use of Agfa paper when plant had been damaged, the use went well beyond what was contemplated by that approval. Anderson J found, therefore, that GFC had a contractual entitlement to terminate the production agreement.

GFC was aware of its right and had first written to the Zimmerman companies identifying the breach in July 1996 noting that it would monitor the situation and expressly reserving its rights. It did not give notice to the Zimmerman companies of its intention to rescind the production agreement until March 1997. Given the circumstances of the case, the court held that the rescission was valid and awarded damages to GFC.

Observations

The recent cases which look at delay make it clear that an election does not have to occur immediately once the right arises. What is crucial, though, is that the party must not engage in any conduct that may jeopardise a later election; this means no conduct that would indicate unequivocally a decision to either continue or terminate the contract. This is significant in the context of construction cases since, as mentioned in section 2.3 above, continuing to work under a contract will almost inevitably constitute an affirmation of the contract. Contractors and, to a lesser extent, principals will rarely have the luxury of time once the right to terminate arises. The election needs to be addressed immediately and a decision made before further work continues.

2.6 Wrongful election—why care must be taken

The doctrine of election can have serious consequences: first, a party can inadvertently waive its right to terminate or rescind the contract; secondly, if the right to elect did not actually exist at the time the termination took place, that party's conduct will usually constitute a repudiation.

Inadvertent waiver

Because the doctrine of election is based on the conduct of parties to a contract, it is possible to "elect" between two rights without actually having the intention to do so. Although the case law discussed above indicates that an election does not necessarily need to occur at the moment that the inconsistent rights arise, it is crucial that the party with the right to elect take care to keep both options open. Unless such caution is exercised, a party may find that by conducting itself in a manner consistent with an affirmation of the contract it has inadvertently waived its right to end the contractual relationship.

Where no right exists

The second type of wrongful election is where the right to terminate never existed, so that the "election" constitutes a repudiation. Such a repudiation can result in a claim for breach of contract and a claim for substantial damages.

In the case of *Amann Aviation Pty Ltd* v. *Commonwealth*[29] the court held that the Commonwealth had wrongfully terminated its contract with Amann Aviation. The case concerned a contract for the supply of an aerial coast-watch service to the Commonwealth of Australia. The contract provided that if the contractor failed to comply with the contract to the satisfaction of the "Secretary" then the Secretary could give a notice in writing requiring the contractor to show why the problem had occurred. If the Secretary was not satisfied with the response, the Secretary was entitled to cancel the contract.

In *Amann,* rather than serving the notice requesting an explanation, the Secretary simply served a notice purporting to terminate the contract. The court found that the termination clause provided an exhaustive method by which termination could occur and because the Commonwealth had not followed this method it had repudiated the contract. The court awarded Amann Aviation substantial damages.

It is beyond the scope of this article to explore this issue further. However, it must be observed that, in the case of large scale engineering and construction projects, the wrongful termination of a contract can have a seriously adverse effect on the party who has purported to exercise the right and may expose that party to a significant claim for a wide range of damages.

3. TERMINATION FOR CONVENIENCE

In recent years it has become more common for construction contracts to contain a "termination for convenience" clause.

Recently, a number of Australian cases have looked at whether a duty of good faith can be implied into a contract at law rather than on an *ad hoc* basis. In particular, some cases focus on whether there is a general duty of good faith in exercising a termination for convenience clause. The case law relating to the issue of implied good faith is summarised succinctly in *Alcatel Australia Ltd* v. *Scarcella*[30] and in *Central Exchange Ltd* v. *Anaconda Nickel Ltd.*[31] For present purposes, it is useful to begin with a general analysis of the two schools of thought regarding an implied duty of good faith. Following this general analysis, the specific issue of termination for convenience clauses will be addressed.

[29] (1990) 92 ALR 601.
[30] (1998) 44 NSWLR 349.
[31] [2002] WASC 94.

3.1 Is there a general implied duty of good faith in commercial contracts?

Renard Constructions (ME) Pty Ltd v. Minister for Public Works

The debate regarding a general implied duty of good faith began as a result of the decision in *Renard Constructions (ME) Pty Ltd* v. *Minister for Public Works*.[32] This case related to a construction contract which included a term allowing the principal (i.e. the Minister) to serve Renard with a notice requiring that it show cause for any failure. If the Minister was not satisfied with the explanation, the clause provided among other things that the contract could be cancelled. Renard was served with a notice requesting that cause be shown and subsequently served a notice cancelling the contract.

Renard viewed this act as a repudiation of the contract, rescinded the contract and commenced arbitration. An issue which was raised, and which became a key element of the subsequent Full Court judgment, was whether the Minister had acted unreasonably. In assessing this question, a majority of the Full Court of the New South Wales Supreme Court held that a duty to act reasonably could be implied *ad hoc* into the contract. Priestly JA went further, suggesting that there was no reason why the same type of reasonableness should not be implied into every contract. In *obiter*, Priestly JA looked at the notion of good faith, in particular its application in other legal systems.

Priestly JA's judgment in *Renard* has been considered in a number of cases across a variety of courts.[33] In contrast, though, some doubt has been expressed in relation to the existence of a general duty of good faith like that mooted in *Renard*.[34] Further, the High Court is yet to address the issue of implied good faith in commercial contracts. In *Royal Botanic Gardens and Domain Trust* v. *South Sydney City Council*,[35] a majority of the High Court noted that though "the issues respecting the existence and scope of a 'good faith' doctrine are important, this is an inappropriate occasion to consider them".[36]

[32] (1992) 26 NSWLR 234.

[33] For the Federal court see: *Hughes Aircraft Systems International* v. *Airservices Australia* (1997) 76 FCR 151 and *Garry Rogers Motors (Aust) Pty Ltd* v. *Subaru (Aust) Pty Ltd* (1999) ATPR 41–703. For the application of *Renard* in New South Wales see: *Hughes Bros Pty Ltd* v. *Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91 (though note that the court did not expressly agree with *Renard*, rather the court noted that it was bound by the decision in *Renard*); *Aiton Australia* v. *Transfield* (2000) 16 BCL 70; *Apple Communications Ltd* v. *Optus Mobile Pty Ltd* [2001] NSWSC 635; and *Burger King Corp* v. *Hungry Jack's Pty Ltd* (Supreme Court of New South Wales Court of Appeal, 21 June 2001, unreported). Recently in Victoria, the *Renard* decision was applied in *Far Horizons Pty Ltd* v. *McDonald's Australia* [2000] VSC 310 in relation to a franchise agreement. For a discussion of *Hughes Bros* see: Adrian Baron, "'Good faith' and Construction Contracts—From Small Acorns Large Oaks Grow" (2002) 22 *Australian Bar Review* 54 at 62.

[34] For contrasting Federal Court opinions see: *Service Station Association Ltd* v. *Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84; and Finn J in *South Sydney District Rugby League Football Club Ltd* v. *News Ltd* (2000) 177 ALR 611. In the Western Australian Supreme Court, two case in particular have suggested an alternative approach to that taken in *Renard*: Parker J made similar comments to those of Finn J in *South Sydney*, in *Central Exchange Ltd* v. *Anaconda Nickel Ltd* (2001) 24 WAR 382 and *Thiess Contractors Pty Ltd* v. *Placer (Granny Smith) Pty Ltd* [2000] WASCA 102. Note that *Central Exchange* has since been appealed to the Full Court ([2002] WASCA 94) but the Full Court confirmed Parker J's decision; this case also includes a detailed discussion on authority relating to an implied good faith term but declined to decide the issue.

[35] (2002) 186 ALR 289.

[36] [2002] HCA 5 at para. 40.

Similarly, Kirby J noted that the issues were important but found it unnecessary to explore the issue further. In *obiter*, though, Kirby J suggested that:

> "... in Australia, such an implied term appears to conflict with fundamental notions of *caveat emptor* that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include."[37]

It is in this uncertain environment that a discussion of the recent approaches to termination for convenience clauses must take place: until the High Court finds an appropriate opportunity to decide the good faith issue, Australian authority on the issue will remain at best unclear and at times contradictory. The uncertainty surrounding "good faith" was noted by the Supreme Court of Western Australia Full Court in *Central Exchange* v. *Anaconda*. Consequently, they took the same approach to that of the trial judge and simply proceeded on the assumption that a good faith term is to be implied, without actually deciding the wider issue.[38]

Burger King Corporation v. Hungry Jack's Pty Ltd

A recent case which strongly propounds the implication of a duty of good faith into commercial contracts is *Burger King Corporation* v. *Hungry Jack's Pty Ltd*.[39] After assessing the authorities stemming from *Renard* and the United States experience, the New South Wales Court of Appeal stated a number of conclusions:

(1) "obligations of good faith and reasonableness will be more readily implied in standard form contracts, particularly if such contracts contain a general power of termination" (at paragraph 163);
(2) the duty is to be implied as a matter of law, rather than on an *ad hoc* basis (at paragraph 164);
(3) there is no distinction "of substance" between good faith and reasonableness (at paragraph 169).

The first of these conclusions will be discussed in more detail below. Suffice to say that in other Australian jurisdictions a general power of termination has been held to be free of a good faith requirement.

The second conclusion in *Burger King* purports to summarise the pro-good faith authorities but, as will be seen below, even if the term is implied at law it seems that the ultimate definition of "good faith" will always be arrived at on a case by case basis.

[37] *Ibid*. at para. 88.
[38] *Central Exchange Ltd* v. *Anaconda Nickel Ltd* [2002] WASCA 94 at paras 54–55.
[39] Supreme Court of New South Wales Court of Appeal, 21 June 2001, BC200103318, unreported.

The third conclusion contradicts some authorities that suggest that reasonableness is actually a stricter requirement than good faith.[40]

Although each of the recent cases looking at good faith is highly relevant to construction contracts, those of major importance relate directly to termination for convenience clauses. For the purposes of discussion, it is interesting to note the approaches taken in *Thiess Contractors Pty Ltd* v. *Placer (Granny Smith) Pty Ltd*,[41] and *Apple Communications Ltd* v. *Optus Mobile Pty Ltd*.[42] The view of the court in the case of *Howtrac Rentals Pty Ltd* v. *Thiess Contractors (NZ) Ltd*[43] is also of interest in the context of the construction environment.

Thiess Contractors Pty Ltd v. Placer (Granny Smith) Pty Ltd

Thiess concerned a "partnering contract" in relation to an open cut mine. The contract contained both a general "good faith clause" and a termination for convenience clause. The contract provided that:

> "6.5.1 [Placer] may, at its option, at any time and for any reason it may deem advisable, cancel and terminate the Contract, in which event [Thiess] shall be entitled to receive compensation . . ."[44]

Placer terminated the contract in reliance on this clause; Thiess commenced proceedings, arguing that the termination was unlawful. Thiess relied in part on the following clause of the contract:

> "1.1.5 The successful operation of this Contract requires that [Thiess] and [Placer] agree to act in good faith in all matters relating both carrying out [of] the works, derivation of rates and interpretation of this document.[45] [*Sic.*]"

(a) The good faith clause. Templeman J found that the right under the contract to terminate for convenience was not related to the "successful *operation* of the contract".[46] Consequently, the existence of the express good faith clause did not impact on Placer's right to terminate. The Court of Appeal did not directly address this issue, but the approach taken by the Full Court suggests that they were in agreement with that of Templeman J.

(b) The termination for convenience clause. Both at trial and on appeal, the Supreme Court of Western Australia was unequivocal in its interpretation of

[40] See for example *Aiton Australia* v. *Transfield* (2000) 16 BCL 70 at 9: "A requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith." Although *Burger King* quotes passages from *Renard* in support of their view, other passages suggest that there is indeed a significant difference between reasonableness and good faith. Nevertheless, it seems that *Burger King* has established that at least in New South Wales part of the good faith requirement will be "reasonableness"; the full court judgment in *Burger King* remains the leading case on this issue in New South Wales and may well be adopted by other jurisdictions.

[41] (2000) 16 BCL 130.

[42] [2001] NSWSC 635.

[43] [2000] VSC 415.

[44] *Thiess Contractors Pty Ltd* v. *Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 130 at 168.

[45] *Ibid.* at 170.

[46] *Ibid.* at 170.

the termination for convenience clause. At trial, Templeman J stated that the "clause appears to be clear and unambiguous in providing Placer with an absolute and uncontrolled right of termination"[47] and went on to note that a requirement of "reasonableness" could not be implied "because such a term would be contrary to the express provision which entitles Placer to terminate: 'at its option, at any time and for any reason it may deem advisable' ".[48] The Court of Appeal reiterated this decision in even stronger language, stating that: "*Thiess* was well aware of the risks of agreeing to the contract with the termination clause in it and accepted those risks."[49]

(c) Conclusions. This case demonstrates the strong view taken by the Western Australian Supreme Court on the implication of a duty of good faith either into a contract or specifically in relation to a clause of a contract which is unambiguous and between parties who understand the risks of agreeing to such a clause. In Western Australia, therefore, the current law is that a termination for convenience clause can be exercised without being subject to an overriding duty of good faith unless there is a clear obligation to fulfil that duty.

Apple Communications Ltd v. Optus Mobile Pty Ltd

This case related to a distribution agreement between Optus and Apple Communications Ltd (Apple). The agreement could be terminated by Optus on 30 days' notice for any reason. Optus terminated the agreement because Optus wanted to "rationalise and regain control of its distribution arrangements".[50] Apple claimed that it was an implied term that the termination clause could only be exercised in good faith.[51] It pleaded three reasons for there being a breach of this term. First, Apple did not have an opportunity to tender under new distribution arrangements. Secondly, that the termination was arbitrary or capricious. The third reason was based on Optus's motivation for the decision to exercise the termination clause.

Windeyer J held as a starting point that good faith "may be implied in contracts and that such duty applies to both performing obligations and exercising rights".[52] However, Windeyer J noted that it is not yet established whether a good faith term must be implied in all contracts. Windeyer J stated that "[a]lthough the contract here is a commercial contract there is no reason not to imply the term".[53]

Windeyer J concluded that the implied term was not made out. In relation to the first "reason" pleaded by Apple, His Honour found that to impose a

[47] *Ibid.* at 168.
[48] *Ibid.* at 171.
[49] *Thiess Contractors Pty Ltd* v. *Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 255 at 258.
[50] *Apple Communications Ltd* v. *Optus Mobile Pty Ltd* [2001] NSWSC 635 at para. 5.
[51] *Ibid.* at para. 13.
[52] *Ibid.* at para. 15.
[53] *Ibid.*

requirement that Apple be given the chance to tender under the new arrangements, would be to place an unjustified condition on the contractual right. In relation to the second "reason", Windeyer J made the following statement: "If a contract allows for termination for any reason then it does not seem to me to be unreasonable to terminate it for a reason unconnected with conduct of a contracting party. If a system of operation is decided to be inappropriate, that would be a proper reason for changing that system"[54]

In relation to the third reason, that is, that Optus wished simply to implement new distribution arrangements, Windeyer J observed that both Optus and Apple were big enterprises and that it had to be accepted that there would be changes contemplated for these types of organisations at any time. His Honour also noted that the Apple representative was aware of the termination clause, although the evidence was that he had not asked any questions about it. Windeyer J was not satisfied that the exercise of the termination right by Optus for the reasons it did so would constitute a breach of good faith. Windeyer J added that "the contract is perfectly clear without it and is effective without it. It does not go without saying".[55]

Howtrac Rentals Pty Ltd v. Thiess Contractors (NZ) Ltd

Howtrac concerned the interpretation of a contract for the hire of earthmoving equipment and vehicles. A large part of the judgment is taken up with an analysis of the composition of the contract to determine Howtrac's entitlement to certain moneys claimed from Thiess. However, in considering Thiess's counterclaim, the court examined whether there could be implied into the contract a term that the parties would act in good faith in responding to requests from the other party.

The facts of the case are complex; what is relevant for this article is that Gillard J clearly accepted that: "... [t]he law has come so far as holding that a duty of good faith both in performing obligations and exercising rights may be implied in a contract."[56] However, His Honour went on to observe that: "But again the obligation of good faith applies in respect to [*sic*] an obligation to perform or in respect to [*sic*] the exercise of a right",[57] and found that where, in this case, Thiess was seeking to establish a breach of an implied good faith term to demand that Howtrac agree to a variation of the contract, His Honour was not persuaded that Howtrac had failed to act either reasonably or in good faith.

3.2 Defining "good faith"

The question which must follow that of whether an implied duty of good faith exists in a contract, is that of its definition. Defining the concept of "good

[54] *Ibid.* at para. 17.
[55] *Ibid.* at para. 20.
[56] *Howtrac Rentals Pty Ltd* v. *Thiess Contractors (NZ) Ltd* [2000] VSC 415 at para. 422.
[57] *Ibid.* para. 424

faith" has been a significant problem for both judges and commentators alike. As stated by S M Waddams: "good faith is a multifarious concept, capable of enlarging or restricting contractual obligations, as the occasion may require".[58] In a recent article, Renwyck Niemann looked at the issue of defining good faith and looked at the different approaches taken by courts and commentators in Australia and overseas.[59] It is worthwhile revisiting this analysis to emphasise the inherent problems associated with defining what constitutes good faith in relation to commercial contracts.

While most case law neglects any analysis of what might comprise the general principle of good faith, both *Aiton Australia* v. *Transfield*[60] and *Service Station Association Ltd* v. *Berg Bennett & Associates Pty Ltd*[61] discuss some of the relevant issues and associated problems. It is also interesting to contrast these cases because each arrived at different conclusions regarding whether a duty of good faith should be applied. Additionally, the judgment in *Burger King* looks at some aspects of defining "good faith".

Service Station Association Ltd v. Berg Bennett & Associates Pty Ltd

In *Service Station Association* Gummow J stated, that when attempting to define good faith:

> "Anglo-Australian contract law as to the implication of terms has heretofore developed differently, with greater emphasis upon specifics, rather than the identification of a genus expressed in wide terms. Equity has intervened in matters of contractual formation by the remedy of rescission, upon the grounds mentioned earlier. It has restrained freedom of contract by inventing and protecting the equity of redemption, and by relieving against forfeitures and penalties. To some extent equity has regulated the quality of contractual performance by the various defences available to suits for specific performance and for injunctive relief. In some, but not all, of this, notions of good conscience play a part. But it requires a leap of faith to translate these well-established doctrines and remedies into a new term as to the quality of contractual performance, implied by law.
>
> "It also is to be borne in mind that treatment of the common law of simple contracts as a coherent whole is of fairly recent origin. There is already a degree of artificiality in forcing the wide range of contractual activities encountered in the community into the framework required by the standard contracts texts."[62]

This suggests that good faith is a fact-driven issue and it is difficult to create an adequate statement of what will constitute "good faith". Arguably, good faith is really just a combination of a number of principles already in existence in relation to contractual relations.

[58] S M Waddams, "Good Faith, Unconscionability and Reasonable Expectations" (1995) 9 *Journal of Contract Law* 55 at 57.
[59] Renwyck Niemann, "Recent Aspects of Good Faith" (2002) 18 BCL 103.
[60] (2000) 16 BCL 70.
[61] (1993) 45 FCR 84.
[62] *Service Station Association Ltd* v. *Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84 at 96–97.

Aiton Australia v. Transfield

In *Aiton*, Einstein J noted that a number of areas of both common law and statute already provide for duties similar to good faith.[63] After noting this, he suggested that it is in fact possible to construct a set of core principles which go to comprise the duty of good faith. Einstein J couched these core principles in the following terms:

> "The good faith doctrine comprises standards/obligations/considerations that seek to temper the deliberate pursuit of self-interest in situations where the conscience is bound. Such unconscionable conduct may be constituted either by:
>
> (a) the person being dishonest;
> (b) the person conducting himself contrary to his word/undertaking in the sense of contradict; or
> (c) the person exploiting a position of dominance or power over a person who is vulnerable relative to him."[64]

In addition to this statement of principle, Einstein J noted: "The good faith concept acquires substance from the particular events that take place and to which it is applied. As such, the standard must be fact-intensive and is best determined on a case-by-case basis using the broad discretion of the trial court."[65]

Burger King Corp v. Hungry Jack's Pty Ltd

To some extent *Burger King* also attempted to define "good faith". This attempt was largely based on Sir Anthony Mason's extrajudicial statement of what constitutes good faith[66]:

(1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);
(2) compliance with honest standards of conduct; and
(3) compliance with standards of contract which are reasonable having regard to the interests of the parties.[67]

In particular, the court focused on the third element which raises two further issues: "reasonableness" and "legitimate interests".[68] The notion of "reasonableness" is somewhat perplexing: first, deciding on a definition is difficult; secondly, in this context it imparts a positive obligation on the party attempting to terminate. The latter of these issues warrants a more detailed discussion. Obviously, the inherent nature of a commercial contract is that

[63] *Aiton Australia* v. *Transfield* (2000) 16 BCL 70 at 89. Some examples are the "business efficacy" test whereby a party to a contract must do everything required to make the contract work (*United States Surgical Corp* v. *Hospital Products* [1982] 2 NSWLR 766) and the duty to act honestly (*Meehan* v. *Jones* (1982) 149 CLR 571).

[64] (2000) 16 BCL 70 at 91.

[65] *Ibid.* at 90.

[66] Supreme Court of New South Wales Court of Appeal, 21 June 2001, BC200103318, at para. 171.

[67] Sir Anthony Mason, "Contract, Good Faith and Equitable Standards in Fair Dealing" (2000) 116 LQR 66 at 69.

[68] *Burger King*, at para. 171.

each party is endeavouring to achieve an outcome which is in its own best interest. As such, the relationship between good faith and self-interest is a complex, if not mutually exclusive, one.

In *Burger King* the court looked at case law relating to "legitimate interests", first noting Finkelstein J's statement in *Garry Rogers Motors (Aust) Pty Ltd* v. *Subaru (Aust) Pty Ltd & Anor*[69] that good faith imposed an obligation "not to act capriciously" but that this did not prevent a party from acting in its own "legitimate interests". To complete the ambiguity of this argument, the duty was described as acting "reasonably" in exercising any powers.[70] The court in *Burger King* continued its analysis by looking at US case law, a key quotation being from *Metropolitan Life Insurance Co* v. *RJR Nabisco Inc*[71]: "In other words, the implied covenant will only aid and further the explicit terms of the agreement and will never impose an obligation 'which would be inconsistent with other terms of the contractual relationship'."[72]

Finally, the court concluded that in relation to the Burger King contract the implied duty to act in good faith and reasonably does not mean that Burger King: "is not entitled to have regard only to its own legitimate interests in exercising its discretion. However, it must not do so for a purpose extraneous to the contract—for example, by withholding financial or operational approval where there is no basis to do so, so as to thwart HJPL's rights under the contract."[73]

3.3 Implications of the "good faith" decisions

There are a number of implications for termination for convenience clauses if a duty of good faith exists as an implied term in all contracts. In preface to this discussion, though, it is crucial to emphasise that the status of law on the point is uncertain and that in the Australian context, there are discrepancies between the various jurisdictions.

Where the court accepts that a contract contains an implied good faith term, this will place an obligation on a party seeking to terminate a contract under a termination for convenience clause (if challenged) to positively demonstrate that it exercised the right for proper reasons consistent with its duty of good faith. A party's failure to do so may expose it to damages or injunctive relief.

[69] (1999) ATPR 41–703.
[70] *Burger King* at para. 172.
[71] (1989) 716 F Supp 1504 at 1517.
[72] *Burger King* at para. 173.
[73] *Ibid.* at para. 185. Note also that this aspect of the *Burger King* judgment has already been applied by Barrett J in *Overlook Management BV* v. *Foxtel Management Pty Ltd*, New South Wales Supreme Court, 31 January 2002, BC200200108, unreported): "It must be accepted that the party subject to the obligation is not required to subordinate the party's own interests, so long as pursuit of those interests does not entail unreasonable interference with the enjoyment of a benefit conferred by the express contractual terms so that the enjoyment becomes (or could become) … 'nugatory, worthless or, perhaps, seriously undermined'. This seems to me to be the principle emerging from … *Burger King* where the various authorities are collected and discussed." At para. 65.

4. CONCLUSION

Election

From an analysis of the recent authorities and from the earlier High Court cases of *Sargent* and *Immer*, principles have emerged which make it easier for practitioners to advise clients when faced with an election under a contract.

However, it is clear that each case will turn on its own facts and advice should not be proffered until a comprehensive review has been taken of all the events taking place from the date on which the right arose under the contract to the date on which the party is seeking to exercise that right.

A claim that election has occurred will require three main elements. First, that the party had the requisite knowledge when the alleged election occurred; if the right is an express contractual right, the party will only need knowledge that the relevant situation has occurred, if not, the party will need both knowledge that the legal right exists and that those facts have occurred. Secondly, it is crucial to show that the relevant situation has actually occurred—that is to say, that the right has crystallised. Finally, it is necessary to demonstrate that the party's conduct is unequivocal and as such demonstrates the election of one right over the other inconsistent right. Where a contractor has continued to work under a construction contract, for example, this requirement will generally be impossible to fulfil.

Failure to consider the knowledge of the party wishing to terminate the contract or failure to take into consideration all steps taken by that party in the period leading up to the purported election may result in the provision of negligent advice for the practitioner and in a claim for wrongful termination against the client.

Termination for convenience

The development of the concept of a duty of good faith in all types of contracts calls for a more judicious approach to the exercise of a termination for convenience clause.

Traditionally, the standard termination for convenience clause in construction contracts has not, in Australia, required the party terminating the contract to demonstrate any good faith elements. The rationale for the clause has been that circumstances can arise where it is not appropriate in (usually) the principal's mind to continue with the contract and it therefore seeks, when entering into the contract, to reserve the right to terminate should it wish to do so.

The termination clause generally sets out the rights and obligations of the parties should the termination occur and by signing the contract, the parties agree to this course of action. The introduction of a requirement that the right be exercised only where the principal does so in good faith is, arguably, inconsistent with the intention of the contracting parties. Whether the right

in each contract will now be subject to a good faith term, will, it would seem from recent authorities turn very much on the facts of each case. It must not, however, be assumed that this traditional right contained in construction contracts, can now be exercised without some consideration of the good faith requirement. As has been highlighted in legal commentary,[74] specific care must be taken in an area, such as construction and engineering, where standard form contracts are used on a wide scale.

[74] Renwyck Niemann, "Recent Aspects of Good Faith" (2002) 18 BCL 103.