

Are Termination for Convenience Clauses Legal?

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Introduction

A termination for convenience ("TC") clause "allows the principal to terminate a contract at its option, regardless of whether the contractor is in default".¹ This means that when exercising the right to terminate under a TC clause, the terminating party is not required to prove any breach of contract. Considering this benefit, these contractual mechanisms are "increasingly being used in both government and private contracts for major construction works".²

This Newsletter

The inclusion of a so called "termination for convenience clause" in a principal "client" contract is typical as is their inclusion in contractors "referred services agreements" and trade contracts.

In this newsletter we look at the effectiveness of such clauses.

Requirements for Effective TC Clauses

Though the common law does recognise the right to terminate for breach of an essential condition, there is generally no common law right to terminate for convenience.³ Consequently, as a TC's force is drawn from its governing contract it is essential that the clause is drafted properly.

When drafting a TC clause parties should consider using unambiguous language, providing a termination fee, and acting in good faith. Absent these requirements, the TC clause may be read down by a court and rendered unenforceable.

¹ Ruth Loveranes, 'Termination for Convenience Clauses' (2012) 14 *University of Notre Dame Australian Law Review* 103, 103.

² Ibid 104.

³ Victoria Lau, 'An Inconvenient Truth With Termination for Convenience', *Clayton Utz* (Web Page, 15 May 2014) <<https://www.claytonutz.com/knowledge/2014/may/an-inconvenient-truth-with-termination-for-convenience>>.

Unambiguous Language

Once the parties have agreed that there will be a right to terminate for convenience it is essential that this is made clear under the contract. As there is no common law protection, absent clear language conveying the right, it is unlikely that the TC clause will be upheld.

The importance of express language in a TC clause was discussed in *Thiess Contractors v Placer (Granny Smith) Pty Ltd*.⁴ In this case the appellant contracted to provide services to Placer for a fixed period in relation to open-cut mining at Placer's Granny Smith gold mine in Western Australia. Under the contract Placer was entitled "at its option, at any time and for any reason it may deem advisable, cancel and terminate the Contract, in which event the Contractor shall be entitled to receive compensation". The compensation was governed by another provision under the Contract. When Placer terminated the Contract, Thiess commenced proceedings against Placer, alleging, amongst other things, that Placer's termination was unlawful. At first instance Templeman J held that the clause provided an "absolute and unfettered discretion".⁵ Though the case was appealed, Templeman J's "decision on the entitlement of the principal to terminate the contract was upheld on appeal".⁶

Good Faith

One of the prevailing issues with a TC clause is whether they should be subject to the duty of good faith. This duty "requires parties to an agreement to exercise their powers reasonably and not arbitrarily or for some irrelevant purpose".⁷

Whilst in *Burger King Corporation v Hungry Jack's Pty Ltd* the NSW Court of Appeal "suggested that such an obligation of good faith should be implied generally into all commercial contracts", subsequent courts have not been as assertive.⁸

More recently, in the case of *David A Harris Pty Ltd v AMP Financial Planning Pty Ltd* the Supreme Court were tasked with considering whether a contractual express right to terminate is subject to an implied term to act in good faith.⁹ Whilst the plaintiffs attempted to rely on supporting case law, the Supreme Court held that "except in cases where a term is implied by statute, the process of finding an implied contractual term in fact must give way to the express terms of the parties' agreement".¹⁰ Moreover, considering the wording of the provision in the case, the Court held that "there is no serious question to be tried that this

⁴ *Thiess Contractors v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 255.

⁵ William Dixon, 'Termination for Convenience or Not?' (2017) 45(3) *Australian Business Law Review* 229.

⁶ *Ibid*.

⁷ 'Acting in good faith', *Australian Competition & Consumer Commission* (Web Page) <

<https://www.accc.gov.au/business/industry-codes/franchising-code-of-conduct/about-franchising/acting-in-good-faith>>.

⁸ (2001) NSWCA 187; William Dixon, 'Termination for Convenience or Not' (2017) 45(3) *Australian Business Law Review* 229; [2001] NSWCA 187.

⁹ [2019] VSC 24.

¹⁰ *Ibid* [59].

carefully-articulated discretion is fettered by an amorphous and unparticularised requirement of good faith".¹¹

As the High Court "has not addressed the implication of a good faith requirement" it would be prudent "for a party wishing to exercise its right" under a TC clause "to turn its mind to the potential constraints imposed by the possible implication of an obligation to act in good faith when exercising its right to terminate for convenience".¹²

Compensation Regime

Another issue with TC clauses is their effectiveness within broader legal principles. Under contract law, consideration, or the price that is asked in exchange for the performance of the contract, is required for there to be a valid contract. Consequently, some have claimed that the "broad termination power" contained within TC clauses "are void because such a broad termination power renders the consideration for that contract illusory".¹³ One way to avoid this issue "is to ensure the contractor is guaranteed something over and above compensation for services rendered", a termination fee.¹⁴ A promise by the principle to "compensate for the consequences of early termination ensures the contract is not rendered void by the TC clause".¹⁵

In considering the adequacy of compensation the courts have found that "no matter how small" the presence of a termination fee will "secure the enforceability of a contract".¹⁶ Interestingly, this rationale led the Federal Court in *Anderson Formrite Pty Ltd v Boulderstone Pty Ltd (No 7)* to conclude that the payment of \$1 by the Principal in the event of termination for convenience was valid.¹⁷ Despite this unique clause, subsequent courts have tended to view that the amount payable under the termination fee is generally a matter of construction.¹⁸

In practice there are "many possibilities" for compensation under construction contracts.¹⁹ According to Victorian Barrister Albert Monichino, these possibilities are:²⁰

- unpaid works as of the date of termination, including work not yet invoiced;
- demobilisation;

¹¹ Ibid.

¹² Jennifer McVeigh and Kimmie Tsukakoshi, 'Termination for Convenience – Not As Easy As It Sounds' (2013) 29(2) *Building and Construction Law Journal* 122, 124.

¹³ Ruth Loveranes, 'Termination for Convenience Clauses' (2012) 14 *University of Notre Dame Australian Law Review* 103, 106.

¹⁴ Ibid 108.

¹⁵ Ibid.

¹⁶ Ibid 103.

¹⁷ [2010] FCA 921.

¹⁸ *Samsung C & T Corp v Laing Orouerke Australia Construction Pty Ltd* [2015] WASC 83, [74] – [77]; *Impero Pacific Group Pty Ltd v Bonheur Holdings Pty Ltd* [2019] NSWSC 286, [41]; *ibid* [64]; *Velvet Glove Holdings Pty Ltd v Mount Isa Mines* (2012) 28 BCL 351.

¹⁹ Albert Monichino, 'Termination for convenience: Good faith and other possible restrictions' (2015) 31 *Building and Construction Law Journal* 68.

²⁰ Ibid.

- contribution to site overheads and profit margin;
- compensation for lost profit on unperformed work; and/or
- compensation for forwarding commitments or downstream liability to subcontractors/suppliers.

Notwithstanding these possibilities, in echoing the case law in this area, Monichino nevertheless concludes that “the proper meaning of a [TC clause] is to be ascertained from the clause read in the context of the rest of the contract, with particular reference to other termination clauses, as well as the factual matrix”.²¹

Interestingly UK Courts have held that TC clauses should provide compensation for “losses, including loss of profit and overheads contribution on the balance of the work”.²² Absent this benefit the Court warned that the clause risks “being treated as leonine and unenforceable and unconscionable”.²³

Ultimately it is important to remember the doctrine of freedom of contract. This doctrine mandates that contracting parties are free to regulate their arrangements. Consequently, it is a matter for the contracting parties to decide what work must be compensated and the amount of compensation.

Intersection with Australian Consumer Law

Under the ACL, a contractual term is “void” if it is “unfair” and the “contract is a standard form contract”.²⁴ To assist contracting parties as well as the courts, section 25 lists examples of unfair terms. Relevantly, section 25(b) provides that “a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract” may be an unfair term.

In *ACCC v Sercorp* the Court considered the application of the ACL to TC clauses.²⁵ One of the contracts that was before the Court included a TC clause which provided:

13. Termination

- a. *As governed by the Headlease, Sercorp may terminate this Service Agreement by giving one month’s written notice to the client at any time.*

Markovic J noted that this clause “is the type of clause envisaged by s 25(b) of the ACL as an example of a contract that may be unfair”.²⁶ Moreover, the Court identified that the defendant’s right to terminate “can be exercised without cause or reason and without giving

²¹ Ibid.

²² *Abbey Developments Ltd v PP Brickwork Ltd* [2003] EWHC 1987, [54].

²³ Ibid.

²⁴ *Competition and Consumer Act 2010* (Cth) Sch 2 s 23(1).

²⁵ [2018] FCA 1044.

²⁶ Ibid [51].

compensation to the counterparty".²⁷ Comparatively, "the counterparty has very limited termination rights under each of the Service Contracts and does not have a corresponding right of termination which can be exercised without cause or reason on one month's written notice".²⁸ Cumulatively these factors "created a significant imbalance in the parties' rights and obligations and would cause detriment if it were applied or relied on by either Servcorp Parramatta or Servcorp Melbourne."²⁹

Conclusion

Whilst TC clauses can be incredibly beneficial for parties to a construction contract, this newsletter has identified the factors that will need to be considered to ensure that the clause is valid and enforceable.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.