TECBAR Review

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The Newsletter of the Technology and Construction Bar Association

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From the Chairman

Six years as TECBAR representative on the Bar Council (2007-13) provided me with vivid detailed and regular reminders of the plight of the publicly funded Bar, in particular the criminal Bar. Although there are occasional victories in the battles with Government and regulators, the general position remains dire. In pursuing their objectives Governments – of all colours – take full advantage of the fact that lawyers in general and barristers in particular are not regarded by the public as a sector of society which is entitled to sympathy. Government and media are willing to focus public comment on the tiny number of barristers who, in a particular accounting year, have received large sums from the public purse; and thus to distort the general picture of modest and declining rewards for demanding and important professional work.

I sometimes hear fellow Recorders with civil or commercial practices criticising the criminal advocates who have appeared before them. My own experience is predominantly one of admiration at their skill and ability in difficult circumstances, for example in getting up a brief at short notice, for example, received the night before, or sometimes that very morning, and in then achieving a tight focus in both their advocacy and their examination of witnesses. To my mind, criticisms from civil/commercial advocates, who enjoy the comparative luxury of time and resources, ring rather hollow. Indeed the focus and economy displayed by most criminal advocates would on occasions be welcome in specialist civil courts.

The risk must be that the present system of criminal defence advocacy by members of the self-employed Bar will be replaced by a salaried Criminal Defence Service; and perhaps that is the true objective. This prospect offers no comfort in terms of efficiency, professionalism or cost to the public purse; and would remove an important element of independence in the system for the defence of those who are charged and indicted by the State.

TECBAR and the other civil SBAs have, within the Bar Council and elsewhere, continued to express their support for the publicly-funded Bar in their battles with Government. We believe in 'One Bar' and will do everything we can to assist our colleagues in the fight for the survival of their part of the profession. We are always looking for practical ways of expressing our support and I would value suggestions from members of TECBAR as to how best we can help.

Michael Soole QC, Chairman

From the Editor

In this Winter Issue of the Review, the 'good faith' theme of Eugene Tan's article in the Summer Issue is picked up in Lucy Garrett's piece concerning 'termination for convenience' clauses. Her article is particularly interesting because, as with Eugene's piece, she takes a comparative approach, looking at the way in which the problems that arise are treated in other jurisdictions as well as our own.

TECBAR's previous chairman, Chantal-Aimée Doerries QC, reviews the recently published 'Construction Adjudication and Payments Handbook' by Dominique Rawley QC, Kate Williams, Merissa Martinez and Peter Land. This is an area of the law that continues to develop at a reasonable pace given the volume of related cases coming before the courts, together with the still relatively recent coming into force of the amendments introduced by the Local Democracy, Economic Development and Construction Act 2009. The book offers a useful gathering together and appraisal of the myriad cases arising in this field.

TECBAR's Adjudication Panel goes from strength to strength. Calum Lamont explains the recent developments in the last article in this Issue. I would encourage those involved in drafting dispute resolution clauses in contracts and appointing adjudicators to consider the use of this valuable resource.

I hope that you enjoy this Winter Issue, and have a happy and restful festive season.

Mark Chennells, Editor

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Termination for Convenience

Introduction

This article[1] will identify the main issues arising on the international and domestic authorities and provide a guide through some of the more knotty arguments.

Termination for convenience clauses are now present in many standard form contracts, including some which include a good faith-type obligation either as part of the standard form (such as NEC3) or as a bespoke amendment. They vary in format, but usually expressly provide that the employer may terminate on notice for any reason and at any time. The contract usually provides for what will happen on a termination for convenience: often the contractor is entitled to be paid for work done; less often, the contractor is also entitled to a payment essentially compensating him for his loss of profits.

The main problem in practice arises where the employer has exercised or wishes to exercise his right to terminate for convenience in order to give the work to an alternative contractor, either because he is able to get a cheaper deal, or because he has concerns as to the performance of his current contractor and wishes to avoid contention as to whether that performance is sufficiently bad to trigger the termination for default clause.

There has been much more discussion of the enforceability of these clauses in this context in the US and Australia. Two main strands of attack emerge from the international authorities. These are:

1. Where there is a duty of good faith, termination for the purpose of appointing an alternative contractor is in breach of that duty (US and Australia).
2. A construction of the clause which permitted termination in order to appoint an alternative contractor would mean that the employer's obligations were "illusory" and in fact provided no consideration because it was entirely at the employer's option whether he performed his obligations or not. The clause would therefore not be construed in this way (US).

Good faith

United States

In the US, it is generally accepted that there is an obligation to act in good faith in exercising contractual rights.[2] In most contexts, it has been accepted that the duty of good faith does not permit termination to obtain a better bargain elsewhere.[3] In relation to federal contracts, this may be limited to the situation in which the better deal was known about as at the date of formation of the contract.[4] The conclusion seems to be almost assumed: the existence of the good faith duty appears to have led to a narrow construction of the clauses, despite references in judgments and commentary to the fact that good faith should not be used as "*a tool for rewiring the parties' Agreement based on unspecified notions of fairness.*"[5]

Australia

A duty of good faith has also been recognised in numerous authorities in Australia.[6] In *Pacific Brands Sport & Leisure v Underworks*,[7] the judge described the duty (obiter) as follows:

> *"… the duty of good faith is an incident (not an ad hoc implied term) of every commercial contract, unless the duty is either excluded expressly or by necessary implication… I presently incline to the view… that the duty is not an independent term of the contract the breach of which would give rise to a remedy, but that it operates as a fetter upon the exercise of the discretions and powers created by the contract, including the power of termination."*

In *Apple Communications v Optus Mobile*,[8] Optus had exercise its right to terminate "per any reason" on one month's notice its contract with Apple for the distribution of Optus' pre-paid mobile telephone products for a three-year term. Apple alleged that the termination was in bad faith because at the time of entering into the contract, Optus knew it was going to restructure in such a way as would require termination of the contract very shortly. The judge held that, "*Even if it were thought that there was a lack of good faith in entering into the contract, I am by no reason certain that this should affect the entitlement to exercise rights under the contract…*"[9]

1 This is an abridged version of the full article, which was co-authored with Hugh Saunders of 3 Paper Buildings and is to be published separately by the Society for Construction Law.

2 See Burton & Andersen on Contractual Good Faith: Formation, Performance, Breach, Enforcement (1995) and (for example) the Uniform Commercial Code §1-304

3 See above and the discussion and common law cases cited in *Good Faith in the Termination and Formation of Federal Contracts* by Federick W Claybrook Jr, 56 Md. L. Review 555 (1997)

4 *Torncello v United States* 681 F.2d 756 (Ct. Cl. 1982) (en banc), although two of the judges disagreed (obiter).

5 *General Aviation Inc v Cessna Aircraft Co,* 703 F. Supp. 637 at 644 (W.D. Mich. 1988)

6 The question of whether it is a general duty or a term to be implied by reference to the usual tests has not been finally determined. See for example *Kellogg v Australian Aerospace* [2007] VSC 200 at paragraph 56.

7 [2005] FCA 288 (Federal Court of Australia)

8 [2001] NSWSC 365

9 Paragraph 19

In *Kellogg v Australian Aerospace*,[10] (an injunction application to prevent Australian Aerospace from terminating its subcontract with Kellogg and taking over the subcontract works itself), Hansen J thought it *"well arguable"* that on the alleged facts there had been a breach of the duty.[11]

In *Leighton v Arogen*[12] (another injunction case), the judge commented that it was *"very hard to see how an entitlement to terminate "for convenience" accompanied by the obligation to pay what the parties must be taken to have agreed would be fair compensation for the consequences of such termination, could be conditioned by any obligation of good faith. On the contrary, I would have thought, such a right was one to be exercised according to idiosyncratic or personal notions of convenience, and not necessarily one constrained by any concept of good faith..."*

It will be seen that in Australia there has so far been no case in which it has been finally decided that a decision to terminate a contract in order to give the work to another contractor is in fact a breach of that duty. By contrast to the US position, the discussion in the authorities puts the emphasis firmly on an initial question of the proper construction of the contract.

England & Wales: implied term

Historically, the English courts have not accepted any general duty[13] of good faith. In *Yam Seng v International Trade Corporation*,[14] Mr Justice Leggatt undertook a careful review of the authorities and identified some accepted principles which he says can be described as aspects of good faith.[15] In particular, he identifies that a power conferred by a contract on one party to make decisions which affect them both must be exercised honestly and in good faith for the purpose for which it was conferred.

In *Mid-Essex Hospital v Compass*,[16] the Court of Appeal discussed the trial judge's reliance on various authorities in support of his conclusion that the clause in the contract permitting the employer to award "service failure points" and thus deduct monies amounted to a discretion which was subject to an implied term that it would not be exercised in an arbitrary, irrational or capricious manner.[17]

Jackson LJ said, *"An important feature of the above line of authorities is that in each case the discretion did not involve a simple decision whether or not to exercise an absolute contractual right. The discretion involved making an assessment or choosing from a range of options, taking into account the interest of both parties. In any contract under which one party is permitted to exercise such a discretion, there is an implied term..."*[18] He held that the service failure points regime was subject to a contractual mechanism which meant there was a right answer. Accordingly there was no discretion which could give rise to the implied term.

The exercise of a power to terminate for convenience is, surely, *"a simple decision whether or not to exercise an absolute contractual right."* On the *Compass* approach, that power would not therefore be circumscribed in any way.

However, in *Selkirk v Romar Investments Ltd*,[19] the Privy Council considered a situation in which the vendor of land exercised his contractual right to rescind on the basis that he was "unable *or unwilling"* [emphasis added] to meet a particular inquiry as to his title made by the purchaser. The Privy Council held that the vendor must not act *"arbitrarily, or capriciously, or unreasonably. Much less can he act in bad faith… Above all, perhaps, he must not be guilty of "recklessness" in entering into his contract, a term frequently resorted to in discussions of the legal principle and which their Lordships understand to connote an unacceptable indifference to the situation of a purchaser who is allowed to enter into a contract with the expectation of obtaining a title which the vendor has no reasonable anticipation of being able to deliver…"*[20]

This case was not cited in *Compass*. However, a right to rescind on the ground of unwillingness also looks like a power to exercise an absolute contractual right. A tension therefore exists between the judgments of the Court of Appeal and the Privy Council.

To a common lawyer, the question arises why an objectively-tested good faith term[21] would be relevant if on the proper construction of the contract the employer was entitled to terminate at his convenience for any reason at all. This is precisely the point made by the Australian court in *Leighton*. It is also the conclusion reached by

10 [2007] VSC 200

11 Paragraph 61

12 [2012] NSWSC 1370

13 There has been limited consideration of express duties. It is clear from *Mid-Essex Hospital Services NHS Trust v Compass Group UK & Ireland Ltd* [2013] EWCA Civ 200 and the application of that case in *TSG Building Services Plc v South Anglia Housing Ltd* [2013] EWHC 1151 (TCC) that such clauses will be construed narrowly where possible. The effect of clauses such as clause 10.1 in NEC3 remains interestingly unclear.

14 [2013] EWHC 111

15 Such as the implied terms of co-operation or not unreasonably withholding consent.

16 [2013] EWCA Civ 200

17 This type of implied term is one of those identified by Leggatt J in *Yam Seng* as falling within his definition of good faith (see paragraph 149).

18 Paragraph 83

19 [1963] 1 WLR 1415

20 At 1423

21 Whether put as a duty to act honestly or not to act arbitrarily, capriciously or unreasonably, etc.

Akenhead J in the very recent case of *TSG Building Services Plc v South Anglia Housing Ltd*. [22]

That case involved an application for declarations under Part 8 relating to the scope of a termination for convenience clause (importantly, the reason for the termination is stated as not known). The judge considered *Yam Seng* and concluded, "*I do not see that implied obligations of honesty or fidelity to the contractual bargain impinge in this case at all. There is certainly no suggestion or hint that there has or might have been any dishonesty in the decision to terminate. So far as fidelity to the bargain is concerned, that depends upon what the bargain actually was…*"[23]

The judge had no difficulty in concluding that the employer was entitled to terminate. This conclusion feels entirely natural to an English black letter lawyer. However, it was not argued that the clause on its proper construction did not permit the relevant termination: as Akenhead J said, that is the crucial question.

Construction of the Contract

In *Torncello v United States,*[24] the US Navy had let a contract to Torncello for grounds maintenance and refuse removal. Item 8 of the contract included the responsibility for pest control. The Navy had a problem with gophers, but it did not call on Torncello to remove them. Instead, it let its gopher problem to an alternative contractor, which had been a competing bidder at tender stage and offered a cheaper price per pest control call out.

The relevant clause provided that on written notice the government "may terminate this contract, in whole or in part, when it is in the best interest of the Government." The Navy relied on the clause as a defence to Torncello's claim for damages, using a "constructive termination" argument available specifically to the US government.[25]

The judgments in *Torncello* are somewhat contradictory.[26] However, all members of the court agreed in holding that the Navy's defence failed on the grounds that on its proper construction, the clause did not permit termination to give the work to another contractor where the employer knew of the cheaper deal at the time of entering into the contract. This must therefore be regarded as the true basis of the decision.[27]

Judge Bennett reviewed the US Federal Court cases before 1974 and pointed out that they are related to situations where there was a post-contract change in the circumstances of the bargain or in the expectations of the parties. He states that these cases recognised that the clause "*was not to be applied as broadly as an untutored reading of the words might suggest.*"[28]

The reason for this was that if the clause was construed broadly, there was a total failure of consideration and the whole contract collapsed. The Court would construe the clause narrowly in order to save the contract. Judge Bennett cites the US textbook Corbin on Contracts:

> *"If what appears to be a promise is an illusion, there is no promise; like the mirage of the desert with its vision of flowing water which yet lets the traveller die of thirst, there is nothing there. By the phrase "illusory promise" is meant words in promissory form that promise nothing; they do not purport to put any limitation on the freedom of the alleged promisor, but leave his future action subject to his own future will, just as it would have been had he said no words at all."*

Judge Bennett comments that "*the government's promise to turn to [Torncello] for all of its pest control work, if it was also implicit in the termination for convenience clause that the government could given [Torncello] none, was no promise at all. The contract would thus fail.*"[29] The court rejected all of the Navy's arguments that it had in fact given some consideration.[30]

The consideration argument has not been expressly discussed in the context of termination for convenience in any other authorities, whether English or in other jurisdictions. This may well be in part because if a contract is in the form of a deed, there is no requirement for consideration. However, readers of this article will be aware that contracts are occasionally not executed as deeds, and in relation to those agreements it is relevant to note that English law does indeed include a concept of "illusory" consideration.

The editors of Chitty suggest that, "*Consideration would be… illusory where it was alleged to consist of a promise the terms of which left performance entirely to the discretion of the promisor… A person does not provide consideration by promising to do something "if I feel like it" or "unless I change my mind,"*"[31] and, elsewhere, "*An agreement may give one party a discretion to rescind.*

22 [2013] EWHC 1151 (TCC)

23 Paragraph 46

24 681 F.2d 756 (Ct. Cl. 1982) (en banc)

25 *Torncello* at pages 5 & 16 and see also *John Reiner & Co v United States* 325 F.2d 438 (Ct. Cl. 1963). The contractually required notice is dispensed with. It appears that federal contracts now include as standard an express provision to the same effect.

26 One of the judges described Judge Bennett's judgment as taking "*a needlessly circuitous route to a destination we all agree on. In getting there, it tosses off needlessly sweeping dicta.*"

27 *Torcello* has subsequently been subject to some inventively restrictive readings by the Federal Circuit, including characterisation as a bad faith case which stands for the "*unremarkable proposition that when the government contracts with a party knowing full well that it will not honor the contract, it cannot avoid a breach claim by adverting to the termination for convenience clause.*" Caldwell & Santmyer Inc v Glickman 55 F.3d 1578 (Fed. Cir. 1995)

28 Page 12. The 1974 case referred to, in which it had been held that a termination in order to grant the work to a cheaper contractor known at the date of entering that contract, was overruled.

29 Page 15

30 See discussion at page 16 onwards of the report.

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That party will not be bound if his promise is "I will only perform if I do not change my mind.""[32]

No authorities are cited for these propositions. However, the point can be understood from first principles: termination for convenience clauses do appear to be a promise to perform unless the employer changes his mind.

The editors of Chitty go on to say that, "*… a promise which is subject to cancellation by A may nevertheless constitute consideration for a counter-promise from B where A's power to cancel is limited by the express terms of the promise: eg where it can be exercised only within a specific time*." Again, this proposition appears to be based on first principles. It is suggested that the English courts, which in general take a robust approach to consideration, may well be willing to accept that the usual requirement for notice prior to terminating amounts to sufficient consideration. Where the contract also provides for payment for the contractor's lost future profit, this may also suffice.[33]

As discussed above, any duty of good faith which exists in English law is unlikely to impose a limit on the scope of the clause. It may be that in the face of a consideration problem, the courts will be willing to apply a broader *Selkirk* type approach in order to save the contract, although this does not necessarily mean that a termination for convenience would be found to be arbitrary, etc. It is possible that a termination to take advantage of a better price, particularly one which was available at the time of entering the contract, might fall within the "recklessness" ground identified in *Selkirk*.

There is a further possibility (also suggested in the 11th Edition of Hudson). That is to construe termination for convenience clauses as subject to certain inherent limitations, taking the contract as a whole. This argument runs by analogy with the well-established principles that (a) a clause which on its face permits the instruction of any variation to the contract (whether by addition or omission or change) is construed so as to be limited to matters which fall within the original scope of the contract[34] and (b) clauses which permit omissions do not in fact permit the omission of work to be given to an alternative contractor.[35] It is suggested that if the termination for convenience clause is construed in a similarly limited way, it no longer renders the promise illusory. This would mean, at minimum, that such clauses did not permit termination so as to give the works to another contractor.[36]

This approach might be particularly interesting in the context either of an implied duty of good faith which involved a duty of fidelity to the parties' bargain, or a similarly construed express duty of good faith. Such a duty might impose a "fetter" on a wide construction of the clause and correspondingly add weight to a submission made by analogy to the variation clauses cases.

Resolution of these points will no doubt have to await a full trial on a termination for convenience clause case. The interrelationship between good faith, consideration and the proper construction of the contract may well eventually be developed in the Court of Appeal.

Lucy Garrett, Keating Chambers

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33 It is tentatively suggested that it could be argued that this is wrong: such payment would be the employer's secondary contractual obligation if the termination was unlawful, and thus amounts to no more than performance of the employer's original obligations under the contract.

34 *R v Peto* (1826) 148 ER 577, *Thorn v Mayor and Commonality of London* (1876) 1 App. Cas. 120 (HL) at 127, per Lord Cairns; *Blue Circle Industries plc v Holland Dredging Company (UK) Ltd* (1987) 37 BLR 40; *Costain Civil Engineering Ltd and anor v Zanen Dredging and Contracting Company Ltd* (1998) 85 BLR 77 and *Trustees of the Stratfield Saye Estate v AHL Construction Limited* [2004] EWHC 3286

35 *Carr v JA Berriman Pty Ltd* (1953) 27 ALJR 273; *Amec Building Ltd v Cadmus Investment Company* (1996) 51 Con LR 105 and *Abbey Developments Ltd v PP Brickwork Ltd* [2003] CILL 2033.

36 Unless expressly stated in the contract. However, the broader the express terms of the clause, the more acute the consideration problem.

A review of *Construction Adjudication and Payments Handbook*

(Authors: Dominique Rawley QC, Kate Williams, Merissa Martinez and Peter Land • Publisher: Oxford University Press)

This book covers all aspects of construction adjudication, whether under the Housing Grants, Construction and Regeneration Act (the Act) or ad hoc, and in addition addresses the provisions concerning payment and notices introduced by the Act. What makes this book stand out is the authors' inclusion of highly accessible case summaries in relation to each topic. The result is a very useful and reliable reference book, aptly described as a 'Handbook'. Each chapter sets out the general principles of the particular topic under consideration and thereafter includes a chronological table of cases, identifying for each case the relevant issue(s) considered in the case and a short précis of the Court's approach. In some chapters shading has been used to allow the reader to easily and quickly identify the most pertinent cases. So, for example, in Chapter 8, Staying Enforcement, the authors have provided three tables of cases: firstly cases where an application for stay of enforcement of an adjudicator's decision was made based on impecuniosity, secondly where the stay application was based on grounds other than impecuniosity, and thirdly, where the Court had to consider the effect of an arbitration agreement. Those cases where a stay

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was granted are shaded for ease of reference. The authors have provided further assistance to the reader by including, in every chapter, summaries of those cases identified as 'key cases', setting out the relevant facts and the material findings. These authors have succeeded in producing a very comprehensive and user friendly compendium of materials relevant to all aspects of adjudication and of payment under the Act.

There are five parts to the Handbook. The first part, Statutory and Contractual Adjudication, explains the scope of the Act, the impact of the Local Democracy, Economic Development and Construction Act 2009, the right to adjudication and the relevance and effect of the statutory scheme. Thereafter, Ad Hoc Adjudication deals with the practical matters which can arise in ad hoc references and also with adjudications falling outside the Act. The longest section is the third part, which considers the effect, enforcement and enforceability of adjudicators' decisions. This area has generated most of the cases which the Courts have had to consider and the chronological tables of cases provide a particularly useful reference tool at the end of the authors' discussion of each of the topics. The fourth part, Payment under Construction Contracts, identifies the relevant sections of the Act and discusses the consequences of the Act and the more recent amendments. The final section of this work covers all remaining issues under the Act and in particular, the provisions concerning notices, reckoning of time, and the application of the Act to the Crown.

Given the thorough and accessible style adopted by the authors, it seems likely that this book will become indispensible for anyone in the construction industry who deals with contracts to which the Act applies.

Chantal-Aimée Doerries QC, Atkin Chambers

The TECBAR Alternative Dispute Resolution Panels: Adjudication

For many years now, TECBAR has administered ADR panels of its members in the fields of arbitration, adjudication, mediation and dispute resolution boards. Construction adjudication, of course, has been a central feature of ADR for 15 years. In addition to instigating the growth of the adjudication jurisprudence through their involvement as advocates in enforcement procedures, TECBAR members have frequently been appointed as adjudicators. TECBAR is able to provide a showcase of experienced adjudicators who are able to accept instructions and act on very short notice.

In 2011, TECBAR formed a new ADR subcommittee (chaired initially by Philip Boulding QC and currently by Alexander Nissen QC) which was charged with the task of updating the accreditation and appointment process in respect of the ADR panels and also to revise the TECBAR adjudication rules in line with recent changes to the relevant legislation. As part of this revamp, all existing members who were named on panels were required to re-apply, and any other members who met the new accreditation requirements were also encouraged to do so. The results have been extremely encouraging, and the TECBAR adjudication panel now numbers some 124 adjudicators.

Agreement between parties on a named individual as Adjudicator is not always possible. TECBAR is able to act as a nominating body for any form of dispute resolution, including adjudication. In this regard, TECBAR has recourse to a body of nominees who are highly qualified specialists in their field of construction law and familiar with the principles of dispute resolution. All TECBAR Adjudicators are required to undertake specialist adjudication training before they can be accredited by TECBAR.

One principal advantage of opting for a TECBAR-nominated Adjudicator is the flexibility of the appointment process, which can be tailored to the particular dispute and requirements of the parties. The appointment process commences with filling in of the TECBAR Application Form for the Nomination of an Adjudicator (see the link at http://www.tecbar.org/dispute-resolution-appointments/adjudication.asp), during which Referring Party will specify from which band of seniority it wishes its Adjudicator to be drawn. The Referring Party may also identify any other particular requirements (e.g. specific call, other professional qualification, particular experience etc.) and indicate whether the requirement(s) is/are essential or desirable. TECBAR will then make a nomination by selecting an Adjudicator within the band of seniority indicated and with regard to any other requirements indicated on the nomination form.

Lastly, readers may be interested to hear of the new TECBAR Adjudication Rules, which were redrafted in 2012. These are also available for downloading on the TECBAR website (http://www.tecbar.org/dispute-resolution-appointments/tecbar-adjudication-rules.asp).

Calum Lamont, Keating Chambers
TECBAR ADR subcommittee

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