THE INTERACTION OF CONTRACT AND EXECUTIVE POWER

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INTRODUCTION

Over the last 25 years, governments of all persuasions in western democracies have increasingly resorted to contract as a means of carrying out governmental tasks and achieving policy outcomes. The use of contract by government is not a new phenomenon but, in more recent times, the increasing use of contract in areas that were traditionally the province of direct government action has been a marked feature of public administration. This movement has spawned a vast literature covering many disciplines and has generated new theories about public administration. One of the difficult issues to resolve in connection with this phenomenon is the sometimes awkward mixture of a private institution — contract — to achieve public purposes.¹

This paper is one of a group of papers on the theme of the interaction between the government's executive power and legislation. This paper is about contract and the executive power. Combining these together, it is appropriate to discuss the interaction between legislation and the use by government of the executive power to make contracts.

It will be seen that most government contracts are made under the executive power which, in turn, is usually not affected by legislation, with the consequence that the government has a very wide power indeed to make contracts. Traditional measures of accountability for the exercise of public power tend to be minimal in controlling the executive power to make contracts. Further, this power may be exercised to bind future governments whose ability to be rid of the contractual obligations is very limited.

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¹ I use the word 'contract' in the lawyer's sense of a legally enforceable agreement. The word is used by public administration scholars in a much broader way to cover any arrangement between two bodies (which may not be separate legal entities) under which one entity is required to do things or achieve outcomes for the other entity. Thus the word is used in a purchaser-provider model where the purchaser and provider may be entities within the one government or may even be employees working for the same employer.
THE INTERACTION OF GOVERNMENT CONTRACTING AND LEGISLATION

When one looks closely at this interaction, the outcome tends to be negative. There is very limited interaction between the exercise of the government’s executive power to make contracts and legislation. The following propositions summarise the various interactions:

1. There is generally no requirement that there be a statutory basis for entering into government contracts. Most government contracts are entered into as an exercise of executive power untrammelled by legislation. It used to be the case that a government could not enter into a contract unless there was a specific statutory power to do so. This theory was discarded in New South Wales v Bardolph.

2. There is no requirement that there be a legislative appropriation of money for the validity of those contracts that involve the expenditure of public money. The contract is effective without an appropriation but payments made under a contract must be sanctioned by an appropriation. Any payment out of consolidated revenue not sanctioned by an appropriation can be recovered. The consequence is that it is possible for the government to be legally committed by a contract, but it refuses to appropriate money for that contract. I have suggested that this would not happen. In any case, the contractor could sue for breach and different procedures are brought into play to satisfy a judgment, although, again, in theory the government could refuse to appropriate money to satisfy the judgment.

3. Legislation may limit or affect the government’s contract-making power. However, the kinds of provisions one finds in finance legislation governing the proper expenditure of public money have been held by the courts to be merely directory and not mandatory — they go to procedures not power — with the consequence that a contract is valid even when the statutory procedures have not been

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2 There are exceptions. In relation to disposal of Crown lands, it is a constitutional requirement that such a contract must be authorised by legislation. See, eg, the discussion in Cudgen Rutile (No 2) Ltd v Chalk [1975] AC 520, 533 (Lord Wilberforce) of this constitutional requirement in Queensland. Another exception is that under the Financial Management and Accountability Act 1997 (Cth) s 37 the Commonwealth cannot borrow money without specific legislative authorisation. See below, text accompanying n 27.

3 Commonwealth v Colonial Combing, Spinning and Weaving Co Ltd (1922) 31 CLR 421.

4 (1934) 52 CLR 455.

5 Kidman v Commonwealth (1925) 37 CLR 233; New South Wales v Bardolph (1934) 52 CLR 455.


8 See ibid [4.36]–[4.37].

9 In Project Blue Sky Inc v Australian Broadcasting Authority (1998) 194 CLR 355, 389–93 (McHugh, Gummow, Kirby and Hayne JJ) the distinction between directory and mandatory was rejected in favour of asking whether it was parliament’s intention to render the relevant transaction invalid if it was made in breach of the legislation. This test is no improvement on the old directory—mandatory distinction. Synonyms used by the courts for ‘directory’ have been ‘modal’, ‘facultative’ and ‘permissive’.
followed.\textsuperscript{10} If legislation limits the power to make a contract (as opposed to dictating the procedure) and the power is exceeded, the contract is void. But such cases are very rare as far as the executive government is concerned,\textsuperscript{11} though there are cases in which statutory corporations have entered into contracts that are void for this reason.\textsuperscript{12} There is no general provision that abolishes the ultra vires rule for contracts made by government corporations as there is for private sector corporations.\textsuperscript{13}

4. Contracts entered into by statutory corporations under what appears to be a statutory power to contract are, according to the Federal Court, not made 'under an enactment' for the purpose of judicial review under the \textit{Administrative Decisions (Judicial Review) Act 1977} (Cth) (\textit{ADJR Act}).\textsuperscript{14} The argument is that the decision to enter into a contract is an exercise of a common law right by the relevant entity and so the statutory conferment of capacity to make contracts does not mean that contracts are made under that statutory provision.\textsuperscript{15} This principle arose in the context of a statutory corporation's power to enter into contracts but it would presumably apply to the government itself if there was a relevant statutory conferment of capacity to contract.

5. Contracts governed by the requirements of the finance legislation are not made 'under an enactment' for the purposes of judicial review under the \textit{ADJR Act}.\textsuperscript{16}

6. Contracts entered into under the Commonwealth executive power found in the \textit{Constitution} s 61 are not made 'under an enactment' for the purposes of judicial review under the \textit{ADJR Act}.\textsuperscript{17}

\textsuperscript{10} Examples are \textit{Australian Broadcasting Corporation v Redmore Pty Ltd} (1989) 166 CLR 454 (in which the ABC failed to comply with a requirement in the \textit{Australian Broadcasting Corporation Act 1983} (Cth) that certain contracts be approved by the Minister, but the contract was held to be valid); \textit{Commonwealth v Crothall Hospital Services (Aust) Ltd} (1981) 36 ALR 567, 582–3; \textit{Northern Territory v Skywest Airlines Pty Ltd} (1987) 48 NTR 20; \textit{Coogee Esplanade Surf Motel Pty Ltd v Commonwealth} (1976) 50 ALR 363, 365 (Glass JA).

\textsuperscript{11} \textit{Kent v Minister of State for Works} (1973) 2 ACTR 1.

\textsuperscript{12} See, eg, \textit{Commonwealth v The Australian Commonwealth Shipping Board} (1926) 39 CLR 1; \textit{Corporation of the City of Unley v South Australia} (1996) 67 SASR 8. This case was successfully appealed on a different point which made the ultra vires question no longer relevant: \textit{Corporation of the City of Unley v South Australia} (1997) 68 SASR 511. See also \textit{Hazell v Hammersmith and Fulham London Borough Council} [1992] 2 AC 1 involving void contracts entered into by a local council.

\textsuperscript{13} Corporations Act 2001 (Cth) ss 124–5. In some state and territory government-owned corporations legislation, the ultra vires rule has been abolished but the position is patchy: see Seddon, above n 7, [2.20].

\textsuperscript{14} \textit{General Newspapers Pty Ltd v Telstra Corporation} (1993) 45 FCR 164 which has been followed in a number of later cases. See \textit{CEA Technologies Pty Ltd v Civil Aviation Authority} (1994) 122 ALR 724; \textit{Chapmans Ltd v Australian Stock Exchange Ltd} (1994) 12 ACLC 512; \textit{Hutchins v Deputy Commissioner of Taxation} (1994) 123 ALR 133; \textit{Giorgas v Federal Airports Corp} (1995) 37 ALD 623.

\textsuperscript{15} This argument is now well established in the case law, though it was initially the subject of criticism. See, eg, Margaret Allars, 'Private Law but Public Power: Removing Administrative Law Review from Government Business Enterprises' (1995) 6 \textit{Public Law Review} 44, 62–3.

\textsuperscript{16} \textit{Hawker Pacific Pty Ltd v Freeland} (1983) 52 ALR 185; \textit{Dardak v Minister for Regional Services, Territories and Local Government} (2001) 182 ALR 419.
Despite all this non-interaction between government contracts and legislation, there is one area where there is a link between legislation and contract and that is in relation to the Commonwealth’s executive power to enter into contracts. The generally accepted theory is that the Commonwealth’s executive power is limited under the Constitution by the legislative heads of power set out in the Constitution. So, the Commonwealth’s power to enter into contracts is limited by what it could do by legislation. This is a strange inversion of the proposition that there is generally no requirement for government contracts to be authorised by legislation. The Commonwealth does not generally have to have been authorised by legislation to make contracts, but the shadow of legislation (meaning the constitutional heads of legislative power) limits what the Commonwealth can do. The same does not apply to the states and territories where the executive power is not limited by reference to subject-matter as the Commonwealth Constitution is. The states and territories therefore have wider powers to contract than does the Commonwealth.

There is much academic controversy about precisely what the limits on the Commonwealth’s power to contract actually mean in a practical sense, but it is reasonably safe to say that the limits impose no real fetter on the Commonwealth’s power to enter into contracts, with the result that the Commonwealth is for practical purposes in the same position as the states and territories, enjoying an unlimited power to enter into contracts.

STATUTORY AGREEMENTS

Proposition 1 above is about there being no requirement for legislation to provide the power to make a government contract. Even so, legislation can provide the power to make a contract (in which case the executive power is displaced). I briefly mention here contracts that are not so much authorised by legislation, but are embodied in legislation. These types of contracts are used for large infrastructure and mining projects and are a hybrid between a contract and a legislative scheme. They raise some quite tricky issues, some of which have not been resolved by the courts. In relation to the present theme of the interaction between government contracts and legislation, suffice it to say that these types of agreements may have the force of legislation (though this is not always the case depending on the drafting of the relevant statute) with the consequence that they displace the executive power. This gives rise to one of the problems: new legislation is needed each time a variation has to be made to the agreement.
Another consequence of elevating an agreement to a set of statutory obligations is that this overcomes the problem of a contract impermissibly purporting to fetter future executive action. It also clears away any possibility of arguing that a contract is impermissibly purging to cut across existing legislation or future possible legislation. In fact agreements of this sort can be used to sweep aside any awkward legislation that may get in the way of the grand project. The Kennett government of Victoria demonstrated this spectacularly in the Crown Casino and CityLink agreements.

CONTRACTS REQUIRED TO BE AUTHORISED BY STATUTE

Proposition 1 above made the point that generally government contracts do not have to be authorised by legislation. Two exceptions were noted in a footnote. One of these exceptions was the subject of an interesting incident some years ago.

The Financial Management and Accountability Act 1997 (Cth) s 37 stipulates that the Commonwealth cannot borrow money without specific legislative authorisation. At the time of the Patricks waterfront dispute in 1998, the Commonwealth wanted to borrow some money to establish a scheme for compensating waterside workers made redundant as a result of re-structuring the industry. The idea was that the Commonwealth would set up the scheme with borrowed money and the money would then be recovered over several years by a levy on stevedoring operations. But, in the politically charged climate of the time, how could the Commonwealth get legislation to enable the borrowing of money for the scheme through Parliament, most particularly the Senate? The solution was to have some other entity borrow the money. The Commonwealth, by the exercise of its executive power, registered a company called the Maritime Industry Finance Company Ltd (MIFCo), a corporation guaranteed by the Commonwealth, and that company then borrowed the money. No legislation is needed for the Commonwealth to give a guarantee under the Financial Management and Accountability Act. (By contrast, under the old Audit Act 1901 (Cth) s 70B the Commonwealth could not give a guarantee unless authorised by an Act.) Thus the Commonwealth neatly stepped around s 37 which was presumably included in the Financial Management and Accountability Act to ensure parliamentary scrutiny of Commonwealth borrowings.

The executive power could thus be used to avoid a legislative requirement aimed at proper accountability in connection with public money.
JUDICIAL REVIEW OF EXECUTIVE POWER

Propositions 4, 5 and 6 above make it clear that judicial review of Commonwealth government decisions to enter into contracts is not available under the ADJR Act despite there being legislation affecting such contracts. It is also clear that it is not possible to challenge any decision made under a government contract.28

This leaves the possibility of administrative law challenge to the exercise of executive power, that is, under the prerogative writs. The scope for this type of challenge is very limited and the cases are rare. The courts have tended to take the view that making contracts, albeit by public bodies using public money, is a 'private' activity not amenable to judicial review.29 In Australia there are cases that show that judicial review is at least possible, though they are rare.

One is Victoria v Master Builders’ Association of Victoria30 in which a successful challenge was mounted to the creation by the Victorian government of a list of construction companies who would not be permitted to respond to government tenders for construction work because of alleged misdeeds in the past. This was not so much a challenge to the exercise of the government's executive power to enter into a contract so much as a challenge to the government's exercise of executive power not to contract with certain entities. However, the outcome of the challenge was very limited with the court making a declaration that the companies had not been accorded procedural fairness.

In MBA Land Holdings Pty Ltd v Gungahlin Development Authority31 the ACT Supreme Court set aside a contract entered into under executive power purely on administrative law grounds after a defective tender process. But, such cases are rare, not the least because it is not possible to obtain damages. It is far more usual to challenge a tender process by resort to an array of private law remedies, such as breach of contract, breach of the Trade Practices Act 1974 (Cth) or estoppel.

THE ‘NEW PREROGATIVE’

The MIFCo story (whereby a statutory provision requiring the government to legislate to raise a loan was avoided by the use of executive power) and the lack of effective judicial review demonstrate the important point that the executive power is power indeed. The government's power to make contracts is, in the absence of specific legislation placing limits on the exercise of that power (itself rare), unfettered and unconstrained. Like natural persons and companies, the government is free to enter into whatever contracts it likes and, despite legislation in the background, such as the finance legislation, the government's contracting activities are not subject to judicial review nor can the contract's validity be challenged if legislation such as finance

28 Australian National University v Burns (1982) 43 ALR 25. Very limited bases for review of decisions made under a contract were recognised by the Privy Council (on appeal from New Zealand) in Mercury Energy Ltd v Electricity Corporation of New Zealand Ltd [1994] 2 NZLR 385.

29 The English case of R v Lord Chancellor; Ex parte Hibbit & Saunders (a firm) (The Times, 12 March 1993) exemplifies this approach. But contrast this case with R v Legal Aid Board; Ex parte Donn & Co (a firm) [1996] 3 All ER 1.


legislation is not adhered to or is bypassed. Whereas natural persons and companies exercise private power, governments can exercise public power through the use of contracts. It is because of this combination that deep concerns have been expressed about the use of contract as a tool of public administration.

Demonstrating extraordinary prescience in 1979, the English academic Terence Daintith saw the writing on the wall and wrote an article labelling the government's contract-making power the 'new prerogative'. 32 The thrust of this article was to comment on the burgeoning use of contract by government, particularly contracting out of important functions formerly performed by public servants, and to note that the system of checks and balances that is supposed to be the hallmark of a modern democracy was being undermined by the use of contract by government. The new prerogative bypasses parliament and, Daintith argued, to do things by contract that previously had to run the gauntlet of parliament, or were traditionally subject to public administration values, was an erosion of democratic institutions.

Janet McLean has also commented 33 on the scope of the executive power in relation to the fact that a contract made by one administration may tie down the next administration and other administrations into the future. 34 Despite the doctrine of executive necessity, which allows governments to break contracts if it is necessary for the public good to do so, and the possibility of legislating to override a contract that is no longer compatible with new policy, the ability of governments to escape contracts by the use of these devices is severely limited. It does not look good in the eyes of rating agencies if governments resort to these devices to cancel contracts. There is even the possibility, contrary to received doctrine in Australia at least, that a government which exercises executive or legislative power which is inimical to an existing contract may be in breach and liable to pay damages. 35 McLean argues that contract ties successor governments down more effectively than does legislation.

Mention has already been made of the transposition of accepted contract values to public contracts — they are 'private' activities — so that a substantial shift takes place

34 One of the most spectacular examples being the Melbourne CityLink contract which is for 34 years or a longer period in certain circumstances. Admittedly this contract was put in place by legislation but the general point is still valid: the Victorian government will, in twenty years' time, still be having to shape policy around this contract, rather than despite it.
35 The decision of the United States Supreme Court in United States v Winstar Corporation, 518 US 839 (1996) demonstrates this. This case is extensively discussed by McLean, above n 33. Another illustration is Lumber Specialties Ltd v Hodgson [2000] 2 NZLR 347 in which a government change of policy did not constitute a breach for most of the contracts relevant to that case because they contained force majeure clauses, but one contract did not and the government had to pay damages. See also Wells v Newfoundland [1999] 3 SCR 199. In Australia it has been suggested that a government that resorts to the doctrine of executive necessity to get out of a contract should pay damages: see Ansett Transport Industries (Operations) Pty Ltd v Commonwealth (1977) 139 CLR 54, 76–7 (Mason J); L'Huillier v Victoria [1996] 2 VR 465, 478 (Callaway JA). In addition, at Commonwealth level (and only at Commonwealth level) legislation taking away contract rights will be invalid under the Constitution s 51(***x) if it amounts to a taking of property without compensation.
away from the kinds of safeguards that were in place under traditional modes of public service delivery.

Taggart has listed public law values:

The list of public law values includes openness, fairness, participation, impartiality, accountability, honesty and rationality...36

Contract contradicts these values almost perfectly, with honesty being the only value common to both contract and public law.37 Contract is traditionally about secrecy, no duty to act fairly, participation of the immediate parties but otherwise not concerned with third parties, no duty to act impartially, accountability only to the extent required by the contract and then only to the other party and no duty to act rationally. When traditional contract values are combined with the public purpose, the mix does not necessarily work very well. There is no, or at least a very limited, special law of contract that applies to government contracts as there is in France and to a lesser extent in the United States. The safeguards for the protection of citizens' interests and wellbeing inherent in public law are simply absent with contract and there has been no adaptation of contract to fill the gap.38 Official reports and enquiries have pointed to the adverse consequences for public accountability of the use of contract by government but with little to show for such criticism.39

I cannot here go into the various ways in which contract and the public purpose do not mix very well40 but I can illustrate with just a couple of examples.

Contract in the sphere of business is often about commercial-in-confidence dealings. There is usually a specific clause that makes this clear. This private sector habit was adopted almost as a conditioned reflex when contracts were drafted for government purposes. The consequence has been a wall of secrecy behind which very large amounts of public resources have been committed, with access being denied even


37 Yes, contract has drawn the line at fraud! It is not possible, for example, to draft an exemption clause that effectively excludes liability for fraud.

38 See the rejection in New Zealand of adoption of a common law principle of prime necessity, championed by Michael Taggart, applicable to control the activities of monopoly public utilities: Vector Ltd v Transpower New Zealand Ltd [1999] 3 NZLR 646.


40 Much has been written on this topic. For some references and discussion of the issues see Seddon, above n 7, [1.4], [1.12]–[1.13], [1.21], [1.24]–[1.25]. See also Mark Freedland, 'Government by Contract and Public Law' [1994] Public Law 86.
to parliamentary committees. Freedom of information legislation excepts commercial secrets and so it was no help to gaining access. Gradually there was a realisation that the simple principle of private contract — the freedom to include whatever the parties liked in their contract — was undermining some important institutions of public accountability. There is no principle of contract law that forbids the inappropriate use of a commercial-in-confidence clause. And it is a simple matter of drafting to blanket the whole contract by such a clause. It has been necessary to adopt new policies dictating transparency to control inappropriate use of these clauses in government contracts.41

Another point to be made about government contracts is that they are inherently difficult to control. It has been said that policy is an unruly horse but it is nothing compared to the use of contract by governments. Once a contract has been made by the government, the government's hand is very much tied in terms of changing direction. Many of the larger contracts in fact commit future governments to expenditure which they are obliged to meet even though technically they could get out of them, either by exercising the right of executive necessity or by not appropriating money to those contracts or by legislating. But either strategy is almost unthinkable and, in any case, governments are concerned to ensure that their credit ratings are not damaged.

Once a contract is in place, not only does it tie the government's hands, but also because of a particular feature of contract law, the thing is liable to get out of control. The relevant feature is that contracts can be changed very simply with a minimum of formality. This may be done 'on the run' with the consequence that the change is legally binding. The change is in fact another contract. The various measures put in place by governments to ensure proper contracting activities make almost no mention of the dangers posed by informal changes. Yet it is a very common occurrence.

The consequence is that the executive power, itself a somewhat unruly horse, is capable of spawning a yet more unruly horse.

CONCLUSION

Much has been said about the executive power distorting the supposed equilibrium represented by the separation of powers doctrine. In the John Lehane Memorial Lecture 200242 Lord Steyn made the point that resort to parliamentary debates and what the executive was trying to achieve (as stated in the explanatory memorandum)

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41 Different measures have been adopted by different governments. The most radical was that of the Bracks government in Victoria following a report on government contracting under the previous administration. With limited exceptions, entire contracts have to be posted on the internet. See Audit Review of Government Contracts, above n 25, vol 1 ch 3. The Commonwealth government is required by a Senate Order to post on the internet a list of contracts over $100,000, stating whether they contain confidentiality clauses, with guidelines that stress that confidentiality should be the exception rather than the rule. The process is monitored by the Australian National Audit Office. See, eg, Australian National Audit Office, *The Senate Order for Departmental and Agency Contracts (Autumn 2003)*, Audit Report No 5 2003–2004 (2003). See also *Government Procurement Act 2001 (ACT)* Part 3.

in the interpretation of legislation shifts power from the parliament to the executive.\footnote{The decision of the House of Lords in \textit{Pepper v Hart} [1993] AC 593 was the focus of Lord Steyn’s attack, framed in terms of the erosion of important constitutional principles.} It might also be said that it shifts power from the judiciary to the executive. A similar theme was canvassed by Justice McHugh in an article about tensions between the executive and the judiciary.\footnote{Justice Michael McHugh, ‘Tensions between the Executive and the Judiciary’ (2002) 76 \textit{Australian Law Journal} 567.}

The use of the government’s executive power to enter into contracts and thereby to carry out important policy initiatives is one example of strong executive power with little by way of checks of that power. I am not suggesting that some elaborate apparatus should be erected to re-balance this situation by, for example, going back to the days when government contracts had to be authorised by legislation. The practical workings of government necessitate that the ideal cannot always be achieved. As Justice McHugh has pointed out:

\begin{quote}
In practice, the doctrine of separation of powers has not been easy to implement. In Australia, the system of party politics, the doctrine of responsible government and the Executive’s desire for an efficient and practical working government have combined to weaken and to some extent erode, the doctrine of separation of powers.\footnote{Ibid 569 (footnotes omitted).}
\end{quote}

It would be impractical to over-regulate the government’s contracting activities, though what constitutes ‘over-regulation’ is an issue that could be the subject of differing opinions. There is already an elaborate set of provisions, legislation (in the form of the finance legislation) guidelines, manuals, best-practice guides, directions and so forth. Accountability for contracts is supposedly ensured through these kinds of measures, by the Auditor-General and by parliamentary committees.

When the use of contracts by government has the effect of de-stabilising the democratic balance, it is not enough to point to the myriad measures that are supposed to ensure efficient and effective use of public money. Those measures are important but they do not go to the kinds of problems mentioned or alluded to by Lord Steyn, Justice McHugh and Terence Daintith. The control of the use of the executive power is not an easy project.

It is possible for the government to self-regulate but this usually happens in the heat of an election. So, for example, the Bracks government in Victoria brought in some quite radical measures to improve transparency of government contracts after the Kennett era. By contrast it was the legislature, through a Senate Order, that introduced transparency requirements to control the Commonwealth government’s over-use of commercial-in-confidence clauses.\footnote{See above n 41.}

Self-regulation is very much a preferred method of regulation by modern governments. Perhaps governments should be more ready to practise what they preach and introduce measures to regulate themselves when the contracting power has the potential for undermining important democratic institutions, as the Bracks government did. One such measure would be a more careful appraisal of whether to use contract at all. The cost-benefit analysis that should be gone through before contracting out should include in the equation the (unmeasurable) cost of eroding important public institutions and citizen safeguards.