

Contractual duty of good faith



**ASSIGN
BUSTER**

Introduction Australia has not yet committed itself to a definitive principle of good faith in contract law. Unlike the legal systems in Europe and the United States, Australia does not demand an explicit legal prerequisite of good faith to form a contract. [1] Decisions in different jurisdictions have however considered the validity of the values identified in the doctrine of good faith within contract law, such as loyalty, honesty and cooperation.

Good faith is valuable because it provides confidence in the formation of contracts between two parties. However there are conflicting views and criticisms of the doctrine of good faith. The “ pragmatic theory of cooperation” [2] underlines the effectiveness of the common law system and emphasizes that there is not a need for a clearly defined doctrine of good faith. Economic theory (the “ repugnancy thesis of self interest”) goes further and criticizes the ability the doctrine holds to oppressively “ constrains the pursuit of self interest. [3] Although the doctrine may be valuable, the ramifications and effects that such a doctrine would create, need to be analyzed and evaluated. In addition this essay will explore how established the doctrine of good faith is within Australian contract law.

Although discussion of the implication of a contractual duty of good faith is often sourced to the judgment of Priestley JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, it is clear that closely related doctrines have formed part of English and Australian law for well over 100 years. Speaking today, it is possible to say that the debate centers not so much on the existence of a duty of good faith in the performance of contractual obligations, but on a number of ancillary, although nonetheless important, questions. These include: (1) Does the duty

arise by implication or as a matter of construction? (2) If the duty arises by implication, does it arise by implication in fact, implication in law or some other process? (3) Is the duty universal, or an incident of particular contracts or classes of contract? (4) To what extent may the duty be negated by express provision or necessary implication? There is also a more fundamental issue: one of policy rather than practicality or theory. It is: to what extent should the courts interfere in the bargains of parties, by imposing terms that the courts think necessary? This is a concern particularly in relation to fully negotiated commercial contracts between parties of equal standing. If the “one size fits all” approach to implication of a duty of good faith is inappropriate, how then (if at all) should the courts approach contracts that are not so negotiated, between parties of unequal standing? Are there other appropriate sources of right or remedy? Or is the concern relevant to the process of implication? Antecedent and related obligations As long ago as 1864, Cockburn CJ said in *Stirling v Maitland* (1864) 5 B&S 840, 852; 122 ER 1043, 1047: “[I]f a party enters into an arrangement which can only take effect by the continuance of a certain existing state of circumstances, there is an implied engagement on his part that he shall do nothing of his own motion to put an end to that state of circumstances, under which alone the arrangement can be operative. Some years later, Lord Blackburn in *Mackay v Dick* (1881) 6 App Cas 251, 263, said that where: “it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect.

It will be observed that Cockburn CJ spoke in terms of “ implied engagement”, whereas Lord Blackburn spoke in terms of “ construction”: foreshadowing a debate that, in relation to good faith obligations, remains current today. Lord Blackburn’s statement of principle was reformulated by Griffith CJ in *Butt v M'Donald* (1896) 7 QJ 68, 70-71 as follows: “ It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other to have the benefit of the contract. It will be observed that his Honour, whilst avoiding specification of the source of the obligation, framed it as one of universal application. The duty identified by Cockburn CJ is a negative one: not to prevent the existence or continuance of that which is necessary to enable the contract to be fulfilled. However, the contractual duty of co-operation may include a positive element.

Where performance of a contract is conditional on some contingency that is (to a greater or lesser extent) within the control of a party, that party must do what is reasonably necessary to enable the condition to be fulfilled, so that the usual remedies for breach of contract – including damages, specific performance and termination – may become available upon breach. See *Perri v Coolangatta Investments Pty Limited* (1982) 149 CLR 537 (as to damages); *Masters v Cameron* (1954) 91 CLR 353 (as to specific performance); and *Kheng v Secola* [2001] WASCA 3 (as to termination). Is there a contractual duty of good faith? At least in New South Wales, the question must be answered “ yes”. It has been settled by other decisions such as *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91, in which Mason P said at 93

that, despite his lack of enthusiasm for the principle, he was bound by what had been decided in Renard. As the later cases it shows that, there has been no retreat from that position.

Certainly, since the decision in *Burger King v Hungry Jack's Pty Ltd* [2001] NSWCA 187, it has been clear – at least in New South Wales – that a duty of good faith in the performance of obligations, and the exercise of rights, may be imposed by implication on the parties to a contract. In New South Wales, the remaining issue is as to the limits of the doctrine. In *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 16, Barrett J said at para [62] that:- “ An additional term implied by law into commercial contracts is a term requiring the exercise of good faith in the performance of the contract. This is now in this State a legal incident of every such contract.... ” Subsequent cases, suggest that it may now be overstating the position to suggest that a duty of good faith is an incident implied by law into all commercial contracts; but the underlying point – that a duty of good faith exists – is valid. The doctrine appears also to have found favour (after some initial wavering) in the Federal Court of Australia: see (by way of example only) *Hughes Aircraft Systems International v Air Services Australia* (1997) 76 FCR 151 and *Pacific Brands Pty Ltd v Underworks Pty Ltd* [2005] FCA 288.

The doctrine has been recognised in Victoria: see, for example, *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228. In that case Buchanan JA, who gave the leading judgment, appeared to accept that an obligation of good faith could be implied into some contracts. However, his Honour at para [25] expressed reluctance “ to conclude that commercial contracts are a class of contracts carrying an implied term of

good faith as a legal incident.... , so that an obligation of good faith applies indiscriminately to all the rights and power [sic] conferred by a commercial contract". His Honour did recognise, in the same paragraph, that it might " be appropriate in a particular case to import such an obligation to protect a vulnerable party from exploitive [sic] conduct which subverts the original purpose for which the contract was made.

" In the result, his Honour did not need to consider whether such a term should be implied into the agreement under consideration because, as he said at para [27], " even if such an obligation was imposed...it was not breached. In the same case Warren CJ who agreed with Buchanan JA but made some additional observations, acknowledged at para [2] that " there has been clear recognition of the doctrine of good faith". However, she pointed out, " courts have, more often than not, decided these matters on other bases and thereby avoided the conceptual difficulty than can attend a concept of a duty of good faith. " It is perhaps unlikely that an intermediate appellate court in Australia would come to a contrary conclusion. However, the question has not been examined by the High Court of Australia, and it might be noted that at least Gummow J (although, whilst a judge of the Federal Court) has expressed some reservations about the general implication of a duty of good faith: *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 44 FCR 84, 97. It was indicated in the introduction, there are policy reasons why this is a question for the High Court in an appropriate case.

Source of the duty There is some controversy as to the source, in the case of a particular contract (or class of contract) of a contractual duty of good faith.

<https://assignbuster.com/contractual-duty-of-good-faith/>

Some, such as Dr Peden, source the duty in construction. That is to say, they regard the duty as one that arises (if at all) on the proper construction of the contract. (In Dr Peden's case, this would seem to reflect her view (Good Faith in the Performance of Contracts (Lexis-Nexis Butterworths, 2003) at [6. 30]) that "implication in fact is a rule of construction".

) In New South Wales, it is clear from the decisions of the Court of Appeal that the duty is regarded as one arising by implication. However, the nature of the implication has been spelled out in different terms. The distinction between implication and fact, implication in law and construction is not always easy to state, and may be to some extent at least a matter of semantics. In *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, Hope JA at 486-487 discussed and differentiated implication in fact and implication in law. His Honour explained that implication in fact was undertaken where the implied term is necessary to give business efficacy to the contract, whereas implication in law occurs where the implied term is viewed as a legal incident of a particular class of contract.

Prima facie, implication in law has the result that the term is implied into all contracts belonging to that class; but the implication may, nonetheless, be excluded having regard to the express terms of a particular contract and the factual matrix in which it was made. The distinction between implication in fact and implication in law was recognised by the High Court in *Esso Australia Resources Ltd v Plowman* (1995) 183 CLR 10. The court returned to the topic in *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410. In the latter case, McHugh and Gummow JJ noted at 449 that in some cases it was more

useful to identify implied terms “ as rules of construction applied to the express terms of the contract”.

They then said at 450: “...the modern and better view is that these rules of construction are not rules of law so much as terms implied, in the sense of attributed to the contractual intent of the parties, unless the contrary appears on a proper construction of their bargain. Their Honours continued by recognising the proposition “ that what would now be classified as terms implied by law in particular classes of case had their origin as implications based on the intention of the parties, but thereafter became so much a part of the common understanding as to be imported into all transactions of the particular description. ” They cited with approval a passage from Halsbury’s Laws of England referring to “ ambiguous terminology” and the shift from implication based on presumed intention to implication as an incident of the class of contract. In *Breen v Williams* (1996) 186 CLR 71, Gaudron and McHugh JJ expressed a similar view as to the shift from implication in fact to implication in law in a particular class of contract. This analysis suggests that the process of implication may be not dissimilar to, or may have some common relationship with, the imposition of terms by business usage through commercial notoriety: see *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226. In *Vodafone Pacific Limited v Mobile Innovations Limited* [2004] NSWCA 15, Giles JA at para [189] referred to *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 and *Burger King* as supporting the proposition that “ an obligation of good faith and reasonableness in the performance of a

contractual obligation or the exercise of a contractual power may be implied as a matter of law as a legal incident of a commercial contract.

” At para [190] his Honour noted an overlap between that process and implication in fact, in circumstances where the question for decision is “ whether for the first time a term should be applied in a particular class of contract. There are other cases that support implication in law as the correct basis. The decision of Finn J in *Hughes Aircraft Systems* has been seen as one such case, that his Honour’s analysis relied heavily on the circumstance that the case involved a public authority; and it may also be viewed equally as supporting implication in fact. Another such case is the decision of Finkelstein J in *Pacific Brands*, where his Honour expressed the view at para [64] “ that the duty of good faith is an incident (not an ad hoc implied term) of every commercial contract unless [it] is either excluded expressly or by necessary implication”. By contrast, it seems to be reasonably clear from what Priestley JA said in *Renard* that his Honour regarded the duty as arising (if at all) by implication in fact: ie, implication based on the test expounded by the Privy Council in *BP Refinery (Westenport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, at 282-283 and adopted on many occasions since: perhaps most notably by Mason P in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337; in particular, relying on the need to give “ business efficacy” to the contract.

However, the subsequent cases – in particular, the analysis of Giles JA in *Vodafone* – seem to show that it is not possible to be dogmatic. That is so firstly because of the evolution from implication in fact in a particular contract to implication in law in contracts of the class to which the particular

contract belongs, and secondly because of the overlap between construction and implication in at least some cases. It is not sure that it is really necessary, as a matter of practicality, to seek either to refine or to resolve the dispute, given that whatever the basis for the implication of the term, it cannot stand in the face of contrary contractual intention (either express or derived by necessary implication from the contract as a whole considered against its factual matrix). (Of course, it exclude the case of terms implied by statute where the statute itself forbids their exclusion.

If the real question is not so much whether an obligation of good faith is to be imposed (to use a neutral term) but, rather, the content of the particular term (ie, the particular incidents of good faith that are sought to be imposed) then, necessarily, one needs to understand the content of the term before one can address the process of implication (assuming, as the cases to which I have referred seem to show, that an obligation of good faith is sourced in implication). This approach finds support in the judgment of Giles JA in *Vodafone* [2004] NSWCA 15 at para [192] where his Honour said that it was only after considering “ a content for the obligation of good faith and reasonableness” that one could “ sensibly enquire whether there is inconsistency with the terms of the contract. ” All this might be thought to indicate that there is much to be said for Dr Peden’s approach, whereby the duty arises (if at all) as a result of a process of construction. That approach has two benefits. First, it focuses on the actual (although objectively ascertained) intention of the parties, viewed against the factual matrix in which the contract was made. Secondly, it is likely to produce an outcome that is based not on a general concept of indeterminate content – “ good

faith” – but on an obligation that is precisely ascertained, by a process of construction, for the particular contract.

But there are problems in her approach: not least, in what is meant by “construction” in this context. Giles JA dealt with Dr Peden’s approach in *Vodafone* at paras [204] to [206]. At para [205] his Honour said: “As so often in the law, it is necessary to make sure that words are the servants, not the master. If it is said that, in determining the full import of cl 18. 4, as a matter of law the power conferred on Vodafone must be exercised in good faith and reasonably, and if that is described as a process of construction, so be it.

But it is not construction by regard to the ordinary meaning of the words used in the agreement. There is an imposition of law, as explained by McHugh and Gummow JJ in *Byrne v Australian Airlines Ltd* by attribution of a contractual intent to the parties, and the rule of construction to which their Honours refer is a rule for imposing in law a meaning on the parties. There is no difficulty in using, in that situation, the accepted description of a term implied by law.” In general terms, the process of construction involves ascertaining the meaning of words used in the context in which they re used.

The starting point is the ordinary meaning of the words; and departure from that ordinary meaning, or the engrafting of something on to that ordinary meaning, may be justified where the context (including that ascertained by reference to the factual matrix) so demands. But, as Giles JA pointed out in the passage as quoted, the ascertainment of an obligation of good faith by a process of construction is not construction in the sense that is just described.

This analysis finds support in the judgment of Mason J in *Codelfa* (149 CLR at 353) where his Honour described the process of implication in law as “ an illustration of the process of construction, though differing from the more orthodox establishment of the meaning of a contractual provision. ” In this context, Dr Peden’s analysis of construction (*op. cit.* at para [6.

1]) as applying the principle of good faith to determine the full impact of the express terms of the contract is not an analysis of the meaning to be attributed to the words, but of the incidents to be engrafted upon the words that the parties have chosen. Whether the duty arises by implication in fact or implication in law (and, a fortiori, if it arises on the proper construction of a contract), it is clear that the duty cannot stand in the face of an express provision or necessary implication negating it; and, if the duty nonetheless exists, that it must accommodate the particular terms of the contract.

Content of the duty of good faithThe concept of good faith is one that is found in many areas of legal discourse: ranging from trust law through administrative law to statutory provisions protective of decision makers (and this list is in no way comprehensive, or even illustrative). In *Secretary, Department of Education, Employment, Training and Youth Affairs v Prince* (1997) 152 ALR 127, Finn J referred at 130 to the protean quality of the concept of good faith, and pointed out that its meaning or content must be derived according to the context in which it is used. Not surprisingly, given the wide range of contexts in which the term is used, a wide variety of meanings has been ascribed to it, to the point where it is not just unwise but positively dangerous to seek to reason from one context to another. In *Renard*, Priestley JA equated the concept of good faith to that of

reasonableness (26 NSWLR at 258), and this approach has found favour in subsequent decisions of the Court of Appeal, Alcatel and Burger King.

In Esso, Buchanan JA at [2005] VSCA para [28] gave some consideration to the content of an implied contractual duty of good faith (picking up what he had said earlier at para [24]). He referred to Priestley JA's equation in Renard (26 NSWLR) at 263 of good faith with reasonableness; and to the view of Finkelstein J in Garry Rogers Motors Aust Pty Ltd v Subaru (Aust) Pty Ltd (1999) ATPR 41-703, where his Honour said at 43, 014 that the obligation of good faith required a party not to act capriciously. Buchanan JA referred further to conduct seeking to prevent the performance of the contract or withholding its benefits, or seeking to further an ulterior or extraneous purpose, as indicating breach of the obligation (and, thereby, indicating further content of the obligation); he drew these examples from the decisions of Byrne J in Far Horizons v McDonalds Aust [2000] VSC 310 at para [120] and Sheller JA in Alcatel (44 NSWLR) at 368. Other approaches have commented on the difficulty – in the view of some commentators, impossibility – of defining good faith, and have relied instead on a negative proposition: good faith is not acting in bad faith (on the basis, apparently, that everyone knows what “ bad faith” is): see Dr Peden, op.

cit. at [7. 2] where a number of cases and texts are cited. That negative or excluding approach finds support in the judgment of Priestley JA in Renard (26 NSWLR at 266); and was picked up with apparent approval in Burger King [2001] NSWCA 187 at [149]. Another approach, referred to by Dr Peden and frequently cited, is that of Sir Anthony Mason in his Cambridge Lectures, 1993 (and see his article “ Contract, Good Faith and Equitable Standards in <https://assignbuster.com/contractual-duty-of-good-faith/>

Fair Dealing” (2000) 116 LQR 66). Sir Anthony suggested that the concept of good faith includes the following elements: (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. (3) Compliance with standards of conduct that are reasonable having regard to the interests of the parties. That definition (perhaps more accurately, explanation) commended itself to me in *Tomlin v Ford Credit Australia* [2005] NSWSC 540 at [116]. Notwithstanding the provenance of that definition, and its citation with approval by Sheller JA (with whom Powell and Beazley JJA agreed) in *Alcatel* (44 NSWLR at 367), there are difficulties with it. Of particular difficulty is the apparent overlap between honesty (the second element) and “reasonable standards of conduct” (the third element). If the standard of reasonable conduct referred to is that which is subjectively reasonable, then it would be subsumed within honesty.

If, however, the standard of reasonable conduct is objective then the test may do no more than restate the general implication of that which is reasonable: see *Hillas & Co Ltd v Arcos Ltd* [1932] All ER Rep 494, 507 where Lord Wright referred to “the legal implication in contracts of what is reasonable, which runs through the whole of modern English law in relation to business contracts.” Familiar examples are the implication of a reasonable time for performance where none is limited by the contract, or a reasonable price for goods or work where none is specified by the contract. Nor we may find the supposed dichotomy between good faith and bad faith persuasive: if only because we may not regard the two concepts as dichotomous. It is plain that a failure to cooperate in achieving the

contractual aim may be caused by oversight rather than intent; but only in the latter case would bad faith be arguable.

Bad faith is but one of the causes of want of good faith. And bad faith may impeach the exercise of a contractual power that is not conditioned by, or subject to, an obligation of good faith in connexion with its exercise. Thus, it is fruitful to enquire, in some a priority way, as to the content of the concept of “good faith” in a contractual context. It is necessary to look at the particular contract, to see what might be comprehended as a particular expression of the general concept of good faith, and then to enquire whether that particular term, or a term having that particular content, should be implied, or whether is excluded by express terms or necessary implication from them.

But it would not follow that, because one particular element of good faith is excluded thereby, or others are likewise excluded. For example, Dr Peden suggests (op. cit. [7. 2]) that one incident of the contractual duty of good faith is “to have regard to the interests of the other party, without subordinating one’s own interests”. The suggested obligation to do that may be denied by an express term (properly construed), or by necessary implication from all the terms (properly construed), of the contract; but it would not follow that there is no duty of good faith whatsoever.

Rather, in those circumstances, there may be a duty of good faith, the content of which is limited, or diminished, by reason of the terms of the contract properly construed. In *Vodafone*, Giles JA concluded that the terms of the particular contract were inconsistent with the implication of an

obligation to act reasonably in good faith. In *Tomlin*, I considered that the terms of the particular contract meant that the defendant could exercise a particular power according to its own interests without reference to the interests of the plaintiffs. In either case it would follow necessarily that the duty of co-operation – to the extent that it was applicable to the relevant contractual promises with which the cases were concerned – was also excluded.

But on Sir Anthony Mason's view, with which, in this respect, co-operation is an incident of the duty of good faith. Express obligations of good faith Plainly, having regard to what I have said, it would be desirable for parties to a contract to incorporate express obligations of good faith if they wished to ensure that they should be so bound. Whilst it is clear that the courts will seek to imply obligations of good faith (including, in particular but without limitation, into commercial contracts), it is equally clear that on well recognised principles implication cannot stand in the face of express terms or necessary implication to the contrary. As the decision in *Vodafone* (and, in a more restricted context, my decision in *Tomlin*) show, there is a wide range of express terms that, of their own force or by necessary implication, will prevent the implication of a contractual duty. Further, if parties to a contract incorporate an express contractual duty of good faith, it is open to them to specify the content of that duty. One possible downside result of drafting an express obligation is that it will be more difficult in addition to imply some additional obligation.

Thus, if a contractual duty of good faith is to be specified as an express term, it is necessary that very careful attention be given to specifying all the

incidents and applications of that duty. In particular, the relationship between the duty of co-operation and the duty of good faith (with the former being subsumed into the latter), it is desirable that any specific requirement of co-operation (including, for example, that a party use “best endeavors” or “reasonable endeavors” to bring about a desired or necessary state of affairs within which the contract is to operate) be specified. This is often seen in contracts for the sale of land where completion is subject to a condition precedent such as the obtaining of finance or the obtaining of development approval: in those circumstances, it is usual to specify that the party for whose benefit the condition is inserted, must use all reasonable or practicable endeavors to bring about its satisfaction. Negating the implication In *Vodafone*, Giles JA considered whether the relevant contractual powers were fettered by an implied obligation of good faith and reasonableness.

He concluded that they were not. Firstly, ([2004] NSWCA 15 at para [195]), he noted that the power “was emphatically described as a sole discretion”, stating that “the point of “sole” lay in the exclusion of any constraint.” That point was reinforced by other provisions of the contract which, his Honour said “weigh against the implied obligation of good faith and reasonableness in the exercise of the power”. At para [197], his Honour pointed to the distinction between the absolute discretion conferred by one clause and the obligation to act reasonably specified in others.

He therefore concluded at para [198] that “[w]ithout more, in my opinion, the implication of the obligation to act in good faith and reasonably in exercising the power of determining target levels...was excluded.” His

Honour relied also on another term of the contract which excluded all implied terms “ to the full extent permitted by Law and other than expressly set out in this Agreement”. One issue in Tomlin concerned the right of the defendant (bailor) to determine the true wholesale value of bailed vehicles, and its right to terminate the Bailment Agreement. The plaintiffs argued that those, and other rights, were conditioned by an obligation that the determination or decision be made in good faith. It may be concluded (although obiter, having regard finds that there was no relevant bad faith) that the rights were not so qualified. There were two reasons why this was so: (1) There was a “ whole of agreement” clause in the Bailment Agreement.

(2)The powers were given to the defendant “ for the protection of its legitimate commercial interests”, and in circumstances where there might be legitimate differences of opinion as to the subject matter of the powers, and where the powers were given to one party for the protection of its commercial interests, there was no basis for constraining the powers by implying an obligation of good faith. However, the question arises, whether the exercise of those powers might be vitiated by the existence of actual bad faith: ie, an exercise for some ulterior and unlawful purpose. In this context, the doctrine of fraud on a power may have some surviving relevance; it is clear in Tomlin at para [120], that the doctrine is of broad application and not limited to the exercise of fiduciary powers: *Houghton v Immer (No 155) Pty Ltd* (1997) 44 NSWLR 46, 52-53 (Handley JA, with whom Mason P and Beazley JA agreed). Freedom of contract We may return to the policy issue flagged in the Introduction.

We may do so at this point because the decision of the Victorian Court of Appeal in *Esso* indicates that one should lean against the general implication into commercial contracts of an obligation of good faith, as an incident imposed by law. This reluctance is apparent from the reasons of Buchanan JA. However, it finds clear expression in the additional reasons of Warren CJ; and her Honour referred to the underlying policy considerations. Her Honour dealt with the policy issues in [2005] VSCA 228 at paras [3] and [4]. She pointed out the role of the law of contract in “achieving certainty in commerce”, noting that the difficulty of achieving precision in the definition of good faith (or in the incidents of a duty of good faith) is not consistent with certainty.

Thus, her Honour concluded, the courts would be wary of interfering, by imposing and enforcing a duty of good faith, in a situation where the parties are of equal bargaining strength. She said: “3. There has also been consideration of the capacity of a contractual party to look after itself and its own interests rather than turn to concepts of good faith for relief. These approaches, more aptly described as judicial reticence, regarding the application of the doctrine of good faith, may be construed as hesitation at the courts’ involvement in contractual performance.

If a duty of good faith exists, it really means that there is a standard of contractual conduct that should be met. The difficulty is that the standard is nebulous. Therefore, the current reticence attending the application and recognition of a duty of good faith probably lies as much with the vagueness and imprecision inherent in defining commercial morality. The modern law of contract has developed on the premise of achieving certainty in commerce.

If good faith is not readily capable of definition then that certainty is undermined.

It might be that a duty of good faith is no more than a duty to act reasonably in performance and enforcement, a long established duty. Of course, some commentators have regarded the duty to act reasonably as properly subsumed within the duty of good faith. 4. Ultimately, the interests of certainty in contractual activity should be interfered with only when the relationship between the parties is unbalanced and one party is at a substantial disadvantage, or is particularly vulnerable in the prevailing context. Where commercial leviathans are contractually engaged, it is difficult to see that a duty of good faith will arise, leaving aside duties that might arise in a fiduciary relationship.

If one party to a contract is more shrewd, more cunning and out-manoeuvres the other contracting party who did not suffer a disadvantage and who was not vulnerable, it is difficult to see why the latter should have greater protection than that provided by the law of contract. " It may be concluded that there is much to be said for the view expressed by her Honour. In general, fully informed parties having adequate bargaining power and negotiating at arms length should be free to settle in detail upon the terms of their bargain; and the courts should be slow to impose their own view of what it was that those parties should have sought to achieve in their bargain. In many cases, certainty is of at least as much significance as morality: at least, in the context of commercial dealings. There are adequate remedies in the law to deal with misrepresentation (or worse) in the course of

negotiation; and, as Warren CJ pointed out, there are remedies available to deal with unconscionable conduct.

In circumstances where none of these remedies is engaged (because the relevant factual conditions have not been met) it is difficult to see why the law should penalise the careful and reward the careless. Those policy considerations argue against implication in law: at least in commercial contracts. And it may be that they should be taken into account in considering implication in fact: in particular, in considering the “ obvious” and “ business efficacy” criteria; and perhaps more generally, as part of the approach to the question of implicit inconsistency. Express exclusion of obligation of good faith There are at least two ways of doing this.

One, relying on what Giles JA said in *Vodafone*, is, in words derived from the language of the contract there considered, to exclude, so far as the law permits, and otherwise than as set out in the contract, any implied terms. The other way is to grasp the nettle and exclude, in express words, any obligation of good faith either in the performance of any contractual duty or in the performance of specified contractual duties. If (through considerations of public image, commercial delicacy, or otherwise) it is not desired to take the second course and grasp the nettle, then the general excluding clause will need to be very carefully drafted. There is authority that a “ whole of agreement” clause will not exclude terms implied by law: *Hart v MacDonald* (1910) 10 CLR 417. The contract in that case stated that “ there is no agreement or understanding between us not embodied in this tender and your acceptance thereof”. The court held that a “ *Mackay v Dick*” type term was not excluded thereby.

The reasons for this are seen most clearly in the judgment of Isaacs J who said at 430 that the whole agreement clause “ excludes what is extraneous to the written contract but does not in terms exclude implications arising on a fair construction of the agreement itself, and in the absence of definite exclusion, an implication is as much a part of a contract as any term couched in express words. ” It follows that any general exclusion would need to follow the concept of the clause in Vodafone, and exclude (among other things) all implied terms except to the extent that the law prohibits this from being done. In Hart, Griffith CJ said at 421 that the implied term “ arises by necessary implication upon a proper construction of the express words”. This, and the formulation of Isaacs J that provide an interesting preview of the current debate. If there is no express exclusion either of implied terms generally or specifically of an implied obligation of good faith, then negation of a duty of good faith would depend on necessary implication from all the other terms of the contracts: a somewhat uncertain process.

The obligation to negotiate in good faithIt is clear in New South Wales that the parties may by contract bind themselves, through an enforceable promise, to negotiate in good faith: Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd (1991) 14 NSWLR 1; Australis Media Holdings Pty Ltd v Telstra Corporation (1998) 43 NSWLR 104. There are very real practical difficulties with this concept. One difficulty lies in identifying breach. Another lies in identifying damages.

(Both of those difficulties were examined, although obiter – because it was held that there as no failure to negotiate in good faith – in Coal Cliff Collieries.) However, statutory requirements for good faith negotiations are

<https://assignbuster.com/contractual-duty-of-good-faith/>

becoming increasingly common (in contexts ranging from consumer protection to native title) and, particularly in the native title context, the content of the statutory duty is being elucidated: see *Western Australia v Taylor* (1996) 134 FLR 211; *Walley v Western Australia* (1996) 67 FCR 366; and *Strickland v Minister for Lands, Western Australia* (1998) 85 FCR 303. If the content of the duty can be developed, and therefore arguments as to its observance or breach resolved in that context, there would seem no reason in principle why the same could not happen in a contractual context. However, the statutory example gives little guidance on resolution of questions of damage. Requirements to Establish “ Good Faith” The implied doctrine of good faith is not clearly established within Australian contract law. Therefore there are no clearly defined criteria or requirement to formulate “ good faith” in a contractual relationship.

Concepts such as cooperation, reasonableness, proper purpose and legitimate interest can at times seem vague, [4] however they are often linked to the implied duty of good faith. It can be argued that in Australia, identifying “ bad faith” in contract law is more feasible than proving “ good faith” (or lack thereof). [5] This “ excluder” analysis formulates an alternative approach in identifying the traits required to formulate “ good faith. ” To establish good faith, a variety of values contrary to those which form the basis of “ bad faith” need to be accumulated. The economic view still supports the right for individuals to negotiate the best contract. Evaluating these philosophies and relative terms individually enables a closer critique of the doctrine of good faith.

Cooperation Cooperation as a duty of contract is implied as a term of law. The concepts of cooperation and loyalty are related and are often used interchangeably [6] Cooperation in contract involves the idea that when a party enters into a contract, opportunities are lost. The authority for cooperation goes back to the 19th century case *Mackay v Dick*[7] Attempting to regain such lost opportunities is an act of bad faith[8] The duty of cooperation implies that parties to a contract “ do all such things as are necessary on his part to enable the other party to have the benefit”. [9] In *Secured Income Real Estate and St Martins Investments* the court held that both parties had an obligation to do all that was necessary to “ secure the success of the contract”.

10] By creating an environment in which the contract can succeed, the parties must be acting in cooperation and therefore demonstrating “ good faith”. The doctrine of cooperation is already “ entrenched” in the Australian common law system. The economic view however is critical of cooperation being used as criterion for contract. The classical model is shaped on the basis of competitive dealing in the formation of contract. The arguments residing from economic law theorists, show how cooperation may take away the individuals right to form and create the best contract.

11] The idea of individualism is central to the classical law formation of contract. It is clear however that to provide an environment to create an agreement in contract, cooperation is required. Therefore for good faith to be in existence, cooperation between the parties needs to be evident in the dealings and formation of the contract. Reasonableness Reasonableness in contract is implied by the courts in law.

Reasonableness requires that due process is carried through appropriately, and that a degree of fairness and justice is carried out by both parties in their contractual relationship. The authority for “reasonableness” is identified clearly in Renard Constructions [12] which shows how the use of power (even that which is constituted in a clause) may be deemed “unfair” and beyond that of the agreement. Priestly JA held that a duty of reasonableness can be implied in a contract and that it has “much in common” with a duty of good faith. [13] The adaptation of such a “reasonableness test” has become a common practice in some jurisdictions.

[14] The economic view on the application of reasonableness is that “to be autonomous a person must not only be given a choice but must be given an adequate range of choices”. [15] Therefore it could be interpreted that the economic view is supportive of the reasonableness test and the application of reason to comprehend the parties’ actions. The test of reasonableness is relevant to good faith due to the close relationship between the terms. For good faith to be in existence, reasonableness needs to be evident in the dealings and formation of the contract. Proper purpose Proper purpose in the use of contractual rights is considered to be an implied duty of good faith.

In conjunction with honesty, proper purpose eliminates “capricious” acts which go beyond that of the original agreement. In *Burger King Corp v Hungry Jacks*, a clause in the franchise agreement stipulated that new restaurants were to be built each year and authorized solely by discretion from the Burger King Corp. [16] At the time of the grievance Burger King Corp wished to cancel the franchise agreement by not authorizing any new restaurants. This act was ultimately deemed to be beyond the intentions of

the parties and undermined the purpose of the contract when the agreement was first developed. [17] The concept of honesty is linked closely to the notion of proper purpose. Honesty is frequently referred to in legislation as part of the definition of “ good faith.

” In the Sale of Goods Act for example section 5(2) states that to be “ deemed in good faith within the meaning of this Act when it is in fact done honestly”. [18] For a contract to succeed, honesty must be evident. Burger King Corp were not acting honestly, therefore the corporation was not acting in good faith. [19] Deceptive acts and lack of honesty can be seen as acts of “ bad faith”, which in Australia could be an offence under the Trade Practices Act.

[20] Therefore it is understandable why honesty is highlighted as a prerequisite for “ good faith”. Legitimate Interest Having regard for the interests of the other contractual party is another term implied in law. [21] Legitimate interest acknowledges that each contracting party has an obligation to consider the other parties interests. The term is closely related to cooperation and loyalty to the contract. Legitimate interest can also be interpreted as a term of fact. In Renard Constructions v Minister for Public Works, Priestly JA commented on the prospect of the term being implied in fact.

[22] For a term to be implied in fact, the requirements established in BP Refinery must be satisfied. 23] These requirements include that formal contracts must be reasonable and equitable, obvious, clear, consistent with express terms and must be necessary to give business efficacy. [24] The

economic view strongly objects to legitimate interest being necessary to give business efficacy. [25] Business efficacy requires that all implied terms in the contract enable the agreement to be carried out in a reasonable manner.

[26] Priestly JA, who introduced the proposition, stated that it may be difficult to satisfy the “ business efficacy” criteria of implied term of fact. [27] The economic view, however describes a “ rational survival of the fittest” agenda in the business world. [28] A person’s rational behavior would include actions made in order to achieve “ the greatest satisfaction or maximum fulfillment of their goals”. [29] From a non-economic viewpoint, however, the formation of “ fair” dealings in the formation of contract is important and it therefore must be incorporated in the implied doctrine of good faith. Excluder Analysis Identifying a course of positive dealings may prove to be too challenging in the analysis of case law. The “ excluder analysis” principle analyses the accumulation of “ bad faith terms”.

Summers identified a list of terms which could incorporate such bad faith acts. These acts include evasion of the spirit of the deal, willful rendering of only substantial performance, abuse of power to determine compliance, interference, and failure to cooperate in the other parties’ performance. [30] Excluder analysis takes the view that “ one cannot state the necessary and sufficient factual conditions for a finding of good faith or bad faith”. [31] This statement highlights the relative ambiguity of the notion of good faith.

There is no clear meaning for the term. Requirements such as cooperation, reasonableness, proper purpose and legitimate interest are all concepts evident within Australian contract law. It is not clear how well “ entrenched”

the doctrine of “ good faith” is within Australian contract law. It is clear however that the requirements which constitute “ good faith” are already “ entrenched” as implied terms of law.

Criticisms of the Doctrine of Good Faith The fundamental principles of good faith do not generally raise such criticism. Criticism is derived from what role good faith should be incorporated into Australian contract law. There are two clearly defined views of the doctrine of good faith. One view is based on an “ ethic of cooperation,” and the other is based on “ an ethic of self interest”.

[32] The “ pragmatic thesis of cooperation” highlights that the common law system does not need a clearly defined doctrine of good faith. As we have seen, the requirements for good faith are already implied in law. The pragmatic view suggests that implementing a doctrine of good faith is not required because the contract law system works effectively without it.

Contract law already includes provisions such as the contra proferentem rule and estoppel [33] which can be applied to issues where good faith may be not evident. It is argued that implementing such a doctrine could result in further confusion and inconsistency in judicial interpretation. The law already has “ entrenched” provisions of good faith so there is no need to “ reinvent the wheel.

” The “ Pragmatic Thesis of Cooperation” In the “ cooperative view” a contract is viewed as a vehicle for mutual support and cooperation[34] This utopian view of contract depicts a world where contracts are formed solely for “ mutually beneficial exchanges”. This view is challenged on the basis that business contracts in reality do not operate in this fashion. Contracts are

made to obtain the maximum benefit from an exchange. In *Burger King Corp v Hungary Jacks*, the franchise agreement was not made with the intention for a “mutually beneficial exchange”. [35] The agreement described an agenda in which profit maximization should exist.

It is unreasonable to expect corporations to engage in contract on the principal that all exchanges are “mutually beneficial”. Therefore any principle of mutually beneficial exchanges, such as the cooperative view, rests on non-contingent principles. [36] Contingency in good faith relies on the standards and customs of a contracting community. For example in *Burger King Corp v Hungary Jacks*, the custom would insinuate hostility between the parties due to their competitive industry.

Custom would give reason to *Burger King Corp* withdrawing the franchise agreement so it would gain access to the market. Non contingent principles draw justification on philosophies of reason, and fairness. [37] The non-contingent view therefore is more socially conscious and upholds the notion of cooperation in dealings. The “Repugnancy Theory of Self Interest” The repugnancy theory of self interest is strongly related to the economic theory of law and is constricted by the requirements of good faith. This principle of “self interest” is a fundamental principle of classical law which views contract as “a vehicle for self interested exchange” [38] for the individual.

Both theories (good faith and self-interest) are fundamentally mutually exclusive and are essentially critical of each other. The courts perception on the doctrine of good faith is somewhat undecided. There is a view that “free exchanges should be permitted” when within the law upholding the

economic view. [39] When considering other jurisdictions however there is some feeling that more emphasis should be given to good faith. [40] The “repugnant view of self interest” describes the use of contract as a vehicle for “self-interested exchange”. [41] This fundamental economic perspective depicts a strong capitalist view of the world in which contracts are formed solely for the purpose of profit maximization.

It supports the statement that “in commercial matters one should not substitute lawyerly conscience for the hard headed decisions made by business people.” [42] A criticism of the repugnant view is that not all contractual relationships in business are conducted with the desire for profit maximization. Not for profit organizations and charities accept donations from the public and businesses in “good faith” that the funds have been reasonably accumulated. The economic view is contrary to a fully fledged doctrine of good faith.

A doctrine of good faith would ultimately constrain the individual’s right to negotiate and form a contract because the individual would need to consider the best interests of the other party. In the business sector this requirement would prove to be at times infomercial and not in the companies’ best interests of profit maximization. There are already well established restrictions in contract law which protect the third party. These include estoppel and the contra proferentem rule. [43] As well the terms which formulate good faith are already implied terms in law and can be utilized by the courts where relevant.

Another reason would be the obvious infringement good faith would have on the classical law principle for the formation of contract. A fully developed doctrine of good faith would require the “ground rules” of contract to change. [44] As the concept of “good faith” is contrary to the competitive notion of “self interest”, negotiations for example would become unreasonable given that the individual wants the best result for himself. Such an implementation would incur drastic changes in the perception and adaptation of contract in Australia. The courts have yet to fully ratify a doctrine of good faith in Australian contract law. Disagreements between jurisdictions and judges have clouded the position of the doctrine in the courts.

Debate still continues over the significant ruling in *Renard v Minister for Public Works*. Priestly JA, as a dissenting judge, proposed that the time was ripe for the imposition “in all contracts of a duty upon the parties of good faith and fair dealing in its performance”. [45] The other judges in the majority did not share his enthusiasm. Meagher JA stated that “there is no possible basis for inflicting such a doctrine on the principal, and his honor was correct to repudiate it.

There is no reason why the principal should have regard to any interests except his own”. [46] These conflicting views do not clearly indicate how “established” the doctrine of good faith is. The judgment ultimately questions how valuable and relevant the doctrine is to Australian contract law. Is the Doctrine of Good Faith Valuable? The doctrine of good faith is relevant to Australian contract law. It is unclear what exactly constitutes good faith as terms such as cooperation, reasonableness, proper purpose and legitimate

interest are already implied in law. Implied terms are pivotal to a contract and without such terms a contract would hold no weight, because the parties would simply not be bound.

Ultimately all parties act in good faith to fulfill the obligations of the contract. The concept of rationalization is common to both the economic and cooperative views because it allows for confidence in the contract to be established. The content of good faith rests upon the standards of society. It can be argued that Australia is still very much a strong capitalist nation which compels contract law to sustain such economic values. The doctrine of good faith under this structure is still valuable in holding the classical principles of offer and agreement in contract law together. For good faith to become essential to form a contract as it is suggested in the cooperative view, a greater change in societal priorities is required.