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Good Faith in the Performance and Enforcement of Australian Commercial Contracts

Theory and Practice

Bill Dixon[*]

1. Introduction

The twists and turns in the ongoing development of the implied common law good faith obligation in the commercial contractual arena continue to prove fertile academic ground.[1] Despite a lack of guidance from the High Court,[2] the lower courts have been besieged by claims based, in part, on the implied obligation.[3] Although lower court authority is lacking consistency[4] and the

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[1] See eg Paterson JM, 'Good Faith in Commercial Contracts? A Franchising Case Study' (2001) 29(4) *ABLR* 270; Webb E, 'The Scope of the Implied Duty of Good Faith-Lessons from Commercial Retail Tenancy Cases' (2001) 9 *APLJ* 1; Carter JW and Stewart A, 'Interpretation, Good Faith and the 'True Meaning' of Contracts: The Royal Botanic Decision' (2002) 18 *JCL* 1; Carlin TM, 'The Rise (and Fall) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25(1) *UNSWLJ* 99; Baron A, 'Good Faith' and Construction Contracts – From Small Acorns Large Oaks Grow' (2002) 22 *Aust Bar Rev* 54; Peden E, *Good Faith in the Performance of Contracts* (Butterworths, 2003); Carter JW and Peden E, 'Good Faith in Australian Contract Law' (2003) 19 *JCL* 155; Wallwork A, 'A Requirement of Good Faith in Construction Contracts?' (2004) 20 *BCLJ* 257; Dixon B, 'Common Law Obligations of Good Faith in Australian Commercial Contracts – A Relational Recipe' (2005) 33 *ABLR* 87; Dixon B, 'What is the Content of the Common Law Obligation of Good Faith in Commercial Franchises?' (2005) 33 *ABLR* 207; Dixon B, 'Can the Common Law Obligation of Good Faith be Contractually Excluded?' (2007) 35 *ABLR* 110; Dixon B, 'What is the Content of the Common Law Obligation of Good Faith in Commercial Leases?' (2007) 14 *APLJ* 113.

[2] A decision of the High Court is still awaited. In *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5; (2002) 76 ALJR 436 Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ noted (at [40]) that while the issues respecting the existence and scope of a 'good faith' doctrine were important, it was an inappropriate occasion to consider them. Kirby J (at [89]) and Callinan J (at [156]) also did not consider it necessary to address these issues.

[3] See, eg, *ACI Operations Pty Ltd v Berri Ltd* [2005] VSC 201, *Advance Fitness v Bondi Diggers* [1999] NSWSC 264; *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Apple Communications v Optus Mobile* [2001] NSWSC 635; *Asia Pacific Resources Pty Ltd v Forestry Tasmania* (unreported, Sup Ct, Tas, Full Ct, Cox CJ, Underwood and Wright JJ, 4 September 1997); *Asia Television Ltd v Yau's Entertainment Pty Ltd* (2000) 48 IPR 283; *Australian Cooperative Foods Ltd v Norco Cooperative Ltd* (1999) 46 NSWLR 267; *Australian Hotels Association (NSW) v TAB Ltd* [2006] NSWSC 293; *Australis Media Holdings Pty Ltd v Telstra Corp Ltd* (1998) 43 NSWLR 104; *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286; *Bamco Villa Pty Ltd v Montedeen Pty Ltd* [2001] VSC 192; *Biscayne Partners Pty Ltd v Valance Corp Pty Ltd* [2003] NSWSC 874; *Blackler v Felpure Pty Ltd* [1999] NSWSC 958; *Central Exchange Ltd v Anaconda Nickel Ltd* (2001) 24 WAR 382; *Central Exchange Ltd v Anaconda Nickel Ltd* [2002] WASCA 94; *Commonwealth Bank of Australia v Renstell Nominees Pty Ltd* [2001] VSC 167; *Commonwealth Development Bank of Australia Pty Ltd v Cassegrain* [2002] NSWSC 965; *Council of the City of Sydney v Goldspar Australia Pty Ltd* [2006] FCA 472; *Cubic Transportation Systems Inc v State of New South*

'decisions in which lower courts have recognised the legitimacy of implication of a term of good faith vary in their suggested rationales',[5] the implied obligation may provide some comfort to a party to 'at least some commercial contracts'[6] faced with a contractual counterpart exhibiting symptoms of bad faith.

Wales [2002] NSWSC 656; *Dalcon Constructions Pty Ltd v State Housing Commission* (1998) 14 BCLC 477; *De Pasquale v The Australian Chess Federation* [2000] ACTSC 94; *Dickson Property Management Services Pty Ltd v Centro Property Management (Vic) Pty Ltd* (2000) 180 ALR 485; *Dockpride Pty Ltd v Subiaco Redevelopment Authority* [2005] WASC 211; *Dresna Pty Ltd v Linknarf Management Services Pty Ltd (In Liq)* [2006] FCA 540; *Easts Van Villages Pty Ltd v Minister Administering the National Parks and Wildlife Act* [2001] NSWSC 559; *Edensor Nominees Pty Ltd v Anaconda Nickel Ltd* [2001] VSC 502; *Elfic Ltd v Macks* [2000] QSC 18; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228; *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310; *Forklift Engineering v Powerlift* [2000] VSC 443; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703; *Gibson v Parkes District Hospital* (1991) 26 NSWLR 9; *Golden Sands Pty Ltd v Davegale Pty Ltd* [2003] VSC 458; *Hoppers Crossing Club Ltd v Tattersalls Gaming Pty Ltd* [2005] VSC 114; *Howtrac Rentals Pty Ltd v Thiess Contractors (NZ) Ltd* [2000] VSC 415; *Hudson Resources Ltd v Australian Diatomite Mining Pty Ltd* [2002] NSWSC 314; *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1; *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91; *Ingot Capital Investments v Macquarie Equity Capital Markets [No 6]* [2007] NSWSC 124; *K & S Freighters Pty Ltd v Linfox Transport (Aust) Pty Ltd* [1999] FCA 1325; *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200; *In Kendells (NSW) Pty Ltd (In Liq) Kendell v Sweeney* [2005] QSC 64; *Lay v Alliswell Pty Ltd* (2002) V Conv R 54-651; *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886; *Luce Optical v Budget Specs (Franchising)* [2005] FCA 1486; *Maitland Main Collieries Pty Ltd v Xstrata Mt Owen Pty Ltd* [2006] NSWSC 1235; *Mangrove Mountain Quarries Pty Ltd v Barlow* [2007] NSWSC 492; *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1; *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd* [2006] VSC 223; *News Ltd v Australian Rugby Football League Ltd* (1996) 135 ALR 33; *NT Power Generation Pty Ltd v Power and Water Authority* (2001) 184 ALR 481; *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143; *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288; *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2006] FCAFC 40; *Pegela Pty Ltd v National Mutual Life Association of Australasia Ltd* [2006] VSC 507; *Radly Corp Ltd v Suncorp Metway Ltd* [2001] VSC 272; *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289; *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* [2007] NSWSC 104; *Saxby Bridge Mortgages Pty Ltd v Saxby Bridge Pty Ltd* [2000] NSWSC 433; *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393; *Shorrlong Pty Ltd v Northern Territory Housing Commission* [1999] NTSC 140; *Softplay v Perpetual* [2002] NSWSC 1059; *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 661; *State of New South Wales v Banabelle Electrical Pty Ltd* (2002) 54 NSWLR 503; *St George Soccer Football Association Inc v Soccer NSW Ltd* [2005] NSWSC 1288; *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 130; *Walker v ANZ Banking Group Ltd (No 2)* (2001) 39 ACSR 557; *Walker v Citigroup Global Markets Pty Ltd* (2005) 226 ALR 114; *Wenzel v Australian Stock Exchange Ltd* (2002) 125 FCR 570; *WMC Resources Ltd v Leighton Contractors Pty Ltd* (1999) 20 WAR 489.

[4] Gyles J has referred to the 'bewildering variety of opinions in the authorities and commentaries as to the implication of terms as to reasonableness and good faith in commercial contracts': *Council of the City of Sydney v Goldspar Australia Pty Ltd* [2006] FCA 472, [166].

[5] *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd* [2006] VSC 223, [166].

[6] To adopt the language employed by Dodds-Streeton J in *ACI Operations Pty Ltd v Berri Ltd* [2005] VSC 201, [172].

Some of the judicial division concerning the good faith obligation flows from the continuing impact of the classical model of contract law.

1.1 The Classical Model

The classical model of contract law[7] was premised upon an adversarial ethic where contractual parties legitimately sought to maximise their own interests.[8] Under this static model,[9] 'contract law simply set ground rules for self-maximising private ordering.'[10] As a corollary of the underlying ideology of liberal individualism,[11] (or, in a market context, 'market individualism'),[12] with the fundamental aim of protection of the individual as an autonomous subject,[13] contractual performance and the exercise of contractual rights and discretions was virtually unrestrained by considerations of the reasonable expectations or the legitimate interests of the other party to the contact.[14] It is these reasonable expectations or legitimate interests that an obligation of good faith in contractual performance and enforcement may operate to protect.

In Australia, the traditional 'English' public policy themes of freedom of contract and the desirability of certainty[15] of contract[16] in commercial dealings

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[7] A model consistent with, and reflective of, the economic theory of laissez-faire: A F Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *LQR* 66, 70.

[8] Acting in the manner of a straightforward maximiser, that is a person who attends only to their own interests: D Gauthier, *Morals by Agreement* (1986) as referred to by R Brownsword, 'Positive, Negative, Neutral: the Reception of Good Faith in English Contract Law' in R Brownsword, N Hird and G Howells (eds), *Good Faith in Contract: Concept and Context* (1999) 13, 32.

[9] Classical contract law focused almost exclusively on the static point of contract formation: M Eisenberg, 'Why There is No Law of Relational Contracts' (2000) 94 *Northwestern University Law Review* 805, 807.

[10] J M Feinman, 'Relational Contract Theory in Context' (2000) 94 *Northwestern University Law Review* 737, 738.

[11] Bigwood refers to contract law's embracement of individualism as its dominant informing ideology: R Bigwood, 'Conscience and the Liberal Conception of Contract: Observing Basic Distinctions Part II' (2000) 16 *JCL* 191, 203. An economic justification for individualism is the notion of the invisible hand transforming what appears to be selfishness into public benefit: Anthony J Duggan, 'Is Equity Efficient?' (1997) 113 *LQR* 601, 603.

[12] A model of self-interested dealers converging on a marketplace, making their one-off exchanges, and going their separate ways: I R Macneil, 'The Many Futures of Contract' (1974) 47 *S Cal LR* 691.

[13] R Bigwood, 'Conscience and the Liberal Conception of Contract: Observing Basic Distinctions Part I' (2000) 16 *JCL* 1, 19.

[14] Subject only to an observance of the like freedom and equal opportunity of all others to pursue their own self-interest: ibid 20.

[15] One commentator has noted that the appeal to the virtue of certainty was the crucial gateway signalling the presence of communication between the practical world of business and the closed doctrinal system of law: H Collins, 'The Sanctimony of Contract' in R Rawlings (ed), *Law, Society and Economy, Centenary Essays for the London School of Economics and Political Science 1895-1995* (1997) 63, 66.

[16] Of course, the desirability of certainty of contract may be questioned. 'It is said by some, and disputed by others, that businessmen prefer certainty to justice, and like to know where they stand.': Lord Justice Staughton, 'Good Faith and Fairness in Commercial Contract Law' (1994) 7 *JCL* 193, 194.

have been commonly repeated by those who seek to retard the development of any contractual obligation of good faith which may be based on competing policy considerations. Members of the judiciary[17] and academic commentators alike have been concerned about the impact of the implied obligation of good faith on the sanctity of freedom of contract and the potential uncertainty[18] that may be introduced into commercial arrangements negotiated at arm's length by commercial entities.

The following recent observations by Warren CJ of the Supreme Court of Victoria are consistent with concerns of this type:

> … 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.[19]
>
> …
>
> 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.[20]

Similar academic concerns have been expressed:

> Good faith … is an imperfect translation of an ethical standard into legal ideology and legal rules. However much it might stimulate research or encourage inquiry into theories underlying contract law, its appropriate home is the university where it can perform these functions without wreaking practical mischief.[21]

1.2 A Changing of the Guard

In more recent times, the validity of some of these traditional concerns has been openly questioned. Sir Anthony Mason has queried:

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[17] The potential for the good faith doctrine to undermine certainty of contract law was raised in, amongst other decisions, *Austotel Pty Ltd v Franklins Selfserve Pty Ltd* (1989) 16 NSWLR 582 and *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393.

[18] It has been observed that certainty can become a mantra, a euphemism for the sanctity of contracts: Collins, above n 15, 67.

[19] *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [3].

[20] Ibid [4].

[21] M Bridge, 'Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?' (1984) 9 *Can Bus LJ* 385, 412.

> why are not good faith and fair dealing superior objects to obsessive insistence on total clarity and certainty in contract? And why is emphasis on the need for good faith and fair dealing not likely to lead to the resolution of business disputes?[22]

As it impacts on the performance and enforcement of commercial contracts, while there remain members of the Australian judiciary who clearly favour the traditional approach,[23] underpinned by an adversarial model and public policy concerns for freedom and certainty of contract, concerns of this nature seem less important to those who see the need for an infusion of good faith into Australian commercial life.[24] While the issue has not yet been determined by the High Court, an obligation of good faith in contractual performance and enforcement has been recognised in numerous decisions of courts lower in the Australian judicial hierarchy. As explored further subsequently, this obligation of good faith is arising in the form of an implied contractual term[25] with the suggestion having been made by a number of lower courts that the implication will be made as an incident of some, if not all, commercial contracts.

Unfortunately this judicial recognition of an obligation of good faith in commercial contractual performance and enforcement has occurred in a manner that has been described as 'tortured'[26] both in its application of precedent and its application of relevant legal tests.

2. Unresolved General Issues

Due to the judicial division apparent in the Australian lower courts, a number of issues remain unresolved concerning the operation of the common law contractual obligation of good faith in commercial contracts:

- To the extent that good faith is an implied contractual term, is the implication made by law, as a matter of fact, some form of hybrid implication of both fact and law or may it be justified on both bases?;

- What meaning should be ascribed to the term 'good faith'?;

[22] Mason, above n 7, 89.

[23] See, eg, Gummow J in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393.

[24] The former Chief Justice of Australia, Sir Anthony Mason, commented (extrajudicially) that the quality of 'Australian commercial life could only profit from an infusion of good faith': Sir Anthony Mason, 'Foreword' (1989) 12 *UNSWLJ* 1, 2-3.

[25] The implication is now predominantly made as a matter of law but there have been instances where the implication was made, or treated, in fact. See, eg, *Advance Fitness v Bondi Diggers* [1999] NSWSC 264; *Dalcon Constructions Pty Ltd v State Housing Commission* (1998) 14 BCLC 477; *Kellcove Pty Ltd v Australian Motor Industries Ltd* (Unreported, Federal Court of Australia, Woodward J, 6 July 1990).

[26] Tyrone M Carlin, 'The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25(1) *UNSWLJ* 99, 122.

- Is good faith based on the reasonable expectations or legitimate interests of the contractual parties or, rather, on community standards?;

- Is the good faith obligation tantamount to an obligation to act reasonably in contractual performance?;

- Should good faith be equated to a fiduciary standard and what is the relevance of motive and self-interest?;

- What correlation is there (if any) between good faith and equitable and/or statutory unconscionability?;

- Apart from statutory unconscionability, what is the relevance of statutory references to 'good faith'?;

- What is the likely content of the good faith obligation?; and

- What are the drafting implications of an implied good faith obligation? More particularly, can the obligation be excluded by an express contractual provision? What is the effect of an inconsistent contractual provision? Does a 'sole discretion' or an 'entire agreement' clause operate to exclude impliedly the good faith obligation? Further, how do public policy considerations impact on drafting?

2.1 An Implied Term Approach

Unlike other jurisdictions, Australia does not have the benefit of a civil or commercial code, a Restatement, overarching principles or the like. In short, in the development of a good faith obligation, Australia has suffered from a sparseness of doctrinal tools. Unlike some jurisdictions[27] where 'fiduciary law has been distorted to this end',[28] the Australian vehicle for judicial development of a good faith obligation has been the implied contractual term.[29]

In this regard, it is important to recognise, and consider, the operation of two categories of implied terms that are potentially quite disparate.[30] Consistent with the classical model of contract law,[31] in the first category are implied terms that reflect the actual intention of the parties. These terms are

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[27] Particularly Canada and the United States: P Finn, 'Commerce, the Common Law and Morality' (1989) 17 *MULR* 87, 96 (footnote 72).

[28] Ibid 96.

[29] Some academic commentators argue that good faith should be regarded as a tool of construction but this approach has not found judicial favour, indeed, has received critical comment.

[30] This is not to suggest that there may not be considerable overlap between the two categories as demonstrated by the decision of Finn J in *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1.

[31] Based on the intentions of the parties to the contract.

commonly described as being implied 'in fact',[32] the implication being made ad hoc.

By contrast with the first category, the second category of implied term will arise regardless of the actual intention of the contractual party, being based on imputed intention.[33] Imposed on the contractual parties by law, terms falling within this category are commonly described as being implied 'as a matter of law' such that the contractual term is implied as a legal incident of a particular class of contract.[34] The label 'default rules' is a further description commonly adopted in discussing implied terms of this type.[35] Of the two categories, terms implied as a matter of law are a relative newcomer with a distinction between the two categories only clearly emerging in the 1950s.[36]

An example of a contractual term being implied in fact is where a term is implied to provide business efficacy to the operation of the contract. The Privy Council in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*[37] set out the five requirements[38] to be satisfied to enable the implication of a term on the basis of business efficacy.[39] The five requirements, which will apply where the contract is a formal one,[40] are:

- The term must be reasonable and equitable;

- The term must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;

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[32] Lindy Willmott, Sharon Christensen and Des Butler, *Contract Law* (Oxford University Press, 2nd ed, 2005) 256.

[33] *Breen v Williams* (1996) 186 CLR 71, 103.

[34] *Australis Media Holdings Pty Ltd v Telstra Corp Ltd* (1998) 43 NSWLR 104, 122-123.

[35] See, eg, See E Peden, *Good Faith in the Performance of Contracts* (Butterworths, 2003) 111.

[36] Commencing with the decision of the House of Lords in *Lister v Romford Ice & Cold Storage Co. Ltd* [1957] AC 555. *Liverpool City Council v Irwin* [1977] AC 239 remains the decision that is most frequently cited for the definitive test for implication of contractual terms, as a matter of law, both in English and Australian authorities.

[37](1977) 180 CLR 266.

[38] As noted by Tadgell JA in *Narni Pty Ltd v National Australia Bank* [2001] VSCA 31, [16] (with whose reasons Buchanan and Chernov JJA agreed) these five requirements, although expressed to operate cumulatively, may nevertheless overlap.

[39] This approach has subsequently been approved by the High Court in a number of decisions, probably the most well-known being *Codelfa Constructions Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337.

[40] Where the contract is informal or incomplete, the test for implication is whether it is necessary for the reasonable or effective operation of the contract in the circumstances: *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 422, 442; *Breen v Williams* (1996) 186 CLR 71, 123-124; *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 74 ALJR 862, 873. Generally, see G Tolhurst and J W Carter, 'The New Law on Implied Terms' (1996) 11 *JCL* 76; M Bryan and M P Ellinghaus, 'Before the High Court Fault Lines in the Law of Obligations: *Roxborough v Rothmans of Pall Mall Australia Ltd* (2000) 22 *Syd LR* 636. On the differences for formal and informal contracts see, eg, J W Carter and G Tolhurst, 'Implied Terms: Refining the New Law' (1997) 12 *JCL* 152.

- The term must be so obvious that 'it goes without saying';[41]
- The term must be capable of clear expression; and
- The term must not contradict any express term of the contract.[42]

A court will approach the task of implication of a contractual term on this basis with a degree of caution. A term will not be implied simply because it may appear to be reasonable. The cautious approach to be adopted has recently been reaffirmed by Kirby J in *Roxborough v Rothmans of Pall Mall Australia Pty Ltd*:[43]

> Whatever may be the precise legal criterion for implying terms into a contract upon which the parties have not expressly agreed, it would always be necessary for a court of our legal tradition to be very cautious about the imposition on the parties of a term that, for themselves, they had failed, omitted or refused to agree upon. Such caution is inherent in the economic freedom to which the law of contract gives effect.[44]

At a general level, the economic freedom that Kirby J refers to will often manifest itself by detailed contractual provisions that seek to regulate expressly all aspects of the contractual relationship. In these circumstances the satisfaction of a number of the five listed requirements may be problematic.[45] As noted by Loke, the close identification between terms implied in fact and the parties' actual, but unstated, intentions permits only limited room for manoeuvre.[46] Probably the greatest individual hurdle is that a term will not be implied 'in fact' where it is contrary to an express term of a contract.[47]

By contrast, as mentioned, if a contractual term is implied 'as a matter of law' the term is implied as a legal incident of a particular class of contract.[48] For implication to occur, a two stage test must be satisfied.[49] The first requirement is that there is an identifiable class of contractual relationship. Traditionally, specific terms have been implied as a matter of law into contracts of a certain class. Examples include contracts between

[41] Employing the standard of the 'officious bystander'. For academic suggestion that the time has come for the officious bystander to be given a 'decent burial' refer to Bryan and Ellinghaus, above n 40, 647.

[42] *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 283.

[43] (2001) 185 ALR 335.

[44] Ibid [161].

[45] In the good faith context, see, eg, *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [60].

[46] A F H Loke, 'Fiduciary Duties and Implied Duties of Good Faith in Contractual Joint Ventures' [1999] *JBL* 538, 547.

[47] This difficulty was noted by Lord Browne-Wilkinson when delivering the judgment of the Privy Council in *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] 1 NZLR 289, [54].

[48] *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd* (1998) 43 NSWLR 104, 122-123.

[49] A Phang, 'Implied Terms in English Law - Some Recent Developments' [1993] *JBL* 242, 245-246.

employer/employee (implied term not to disclose secret processes), contracts for the sale of goods (implied terms of reasonable fitness and merchantable quality and that payment and delivery of goods are concurrent obligations),[50] contracts of lease between landlord and tenant (implied term that premises will be reasonably fit for habitation) and in contracts of carriage by sea (an implied term of seaworthiness).[51] Notwithstanding these traditional classes, it is clear that the classes of contracts in which the law will imply terms is not closed.[52]

The second requirement is to satisfy the test of necessity.[53] This test emanates from what is regarded as the authoritative decision on the test for implication of terms in law (both in England and Australia),[54] *Liverpool City Council v Irwin.*[55] In this well-known decision, the issue for determination by the House of Lords was whether the Council, as landlord, was under any implied obligation to maintain and repair the common parts of the building which were in the Council's control. In a speech often cited as describing the test to be satisfied (if a term were to be implied, as a matter of law), Lord Wilberforce[56] opined that 'such obligation should be read into the contract as the nature of the contract itself implicitly requires, no more, no less: a test, in other words of necessity.'[57] Applying this test, Lord Wilberforce held that there was an implied term whereby the landlord Council was obliged to take reasonable care to keep these areas in reasonable repair.[58]

From subsequent Australian cases it is apparent that 'necessity' is commonly understood to mean that 'unless such a term be implied, the enjoyment of the rights conferred by the contract would or could be rendered nugatory, worthless, or, perhaps, be seriously undermined.'[59] Notwithstanding this common formulation, a wider conception of the test of necessity is also apparent in certain decisions. In these instances, wider policy reasons have been seen to support the implication of a contractual term as a matter of

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[50] Now codified by statute: see, eg, *Sale of Goods Act 1896* (Qld).

[51] *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 448; *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, 487; Glanville Williams, 'Language and the Law' (1945) 61 *LQR* 403 as referred to in *Burger King* [2001] NSWCA 187, [165].

[52] *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, 487 (Hope JA).

[53] *Esso Australia Resources Ltd v Plowman* (1995) 183 CLR 10, 30 (Mason CJ).

[54] Albeit a decision which remains confusing given its myriad treatment of both the test and its application: Peden, above n 35, 70.

[55] [1977] AC 239.

[56] With whom Lord Fraser agreed: [1977] AC 239, 270.

[57] [1977] AC 239, 254.

[58] Ibid 256.

[59] *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 450 (McHugh and Gummow JJ); *Breen v Williams* (1996) 186 CLR 71, 103 (Gaudron and McHugh JJ), 124 (Gummow J). An alternative way of describing the test of necessity is whether the term sought to be implied is necessary in contracts of the class to which the subject contract belongs in the sense that, without it, the whole basis of the contracts in the class would be rendered futile: *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, 488 (Hope JA, Samuels and Priestley JJA agreeing).

law.[60] That said, it has been recognised that the narrower conception of the test of necessity will address 'the broad range of instances where the issue of such an implication ordinarily arises.'[61]

This distinction between the two categories of implied terms, namely terms implied in fact and terms implied as a matter of law, may be critical when considering the implied obligation of good faith in the performance and enforcement of commercial contracts.

For example, it may not be possible to imply a term of good faith based on business efficacy where the contract would be effective without it,[62] where the term is not so obvious that it goes without saying[63] or where the implication of the term would be inconsistent with an express term of a contract. These potential difficulties in satisfying the requirements for an obligation of good faith to be implied, as a matter of fact, were foreseen by Priestley JA in *Renard*[64] and they have proven to be significant obstacles.[65] The difficulty being, as Peden notes, that it will be difficult to satisfy the strict requirements of the business efficacy test in circumstances where the contract can 'work' if the parties perform their contractual obligations in their own interests.[66]

In stark contrast, due to the different basis for implication, even the presence of an inconsistent, express, contractual term may not necessarily operate as an impediment to the implication of a term of good faith in contractual performance and enforcement, as a matter of law. Given this contrast, it is perhaps not surprising that there are instances where judges have implied a good faith obligation as a matter of law expressly due to 'the difficulty of complying with the criteria for an implication in fact.'[67]

2.1.1 Commercial Contracts – An Identifiable Class?

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[60] Policy reasons have been expressly articulated in the past, see, eg, *Lister v Romford Ice* [1957] AC 555, 576-579; *Simonius Vischer & Co Holt & Thompson* [1979] 2 NSWLR 322, 348. In the specific context of an implied obligation of good faith, Finn J has expressly acknowledged that considerations of public policy can and do have an overt role to play in some instances: *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1, 39.

[61] *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1, 39.

[62] See, eg, *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 661.

[63] See, eg, *Saxby Bridge Mortgages Pty Ltd v Saxby Bridge Pty Ltd* [2000] NSWSC 433.

[64] (1992) 26 NSWLR 234, 258.

[65] Once again demonstrated in *Christopher John De Pasquale v The Australian Chess Federation Incorporation (AO 1325)* [2000] ACTSC 94. Also, in *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143 Barrett J quickly dismissed the suggestion that an implied term of good faith arose on the grounds of presumed intention or business efficacy: at [60]. The answer to the question whether, an obligation of good faith, implied by law into the parties' contract, had been breached, was more vexed.

[66] Peden, above n 35, 132.

[67] *Central Exchange Ltd v Anaconda Nickel Ltd* [2002] WASCA 94, [52] (Steytler J) as referred to by Peden, above n 35, 133.

In good faith jurisprudence, the decision of the New South Wales Court of Appeal in *Burger King*[68] remains significant. In this case the Court of Appeal cited the earlier decision of *Alcatel Australia Ltd v Scarcella*[69] with evident approval. In both instances the Court of Appeal was dealing with a commercial contract and, in both instances, the court was prepared to imply a term of good faith in contractual performance and enforcement. Unfortunately, it seems the mere fact that a commercial contract was involved in both instances has resulted in these decisions being erroneously accepted as a precedent for a legally wider proposition. The decision in *Burger King*[70] has been repeatedly cited by judges at first instance in New South Wales as authority for the proposition that a duty of good faith will be implied, as a matter of law, in all commercial contracts.[71]

However, at no stage was this proposition expressly stated by the Court of Appeal[72] in either *Alcatel Australia Ltd v Scarcella*[73] or *Burger King*.[74] Although the Court of Appeal in *Burger King*[75] did state the two tests for implication of a contractual term as a matter of law,[76] they merely seemed to satisfy themselves, in a very cursory manner, that the second test of necessity was met.[77] The satisfaction (or otherwise) of the first test, that there should be a recognised class of contract, was not discussed. The only comment made in this regard was that the contract in issue did not fall within the rubric of any traditional class of contract.[78] The absence of any discussion of the satisfaction of the first test, and the limited and largely unhelpful discussion of the second test, militates against the view that this decision should be accepted as authority for the proposition that a duty of good faith will be implied, as a matter of law, in that class of contracts being commercial contracts per se.

The veracity of this observation has been confirmed by a more recent decision of the New South Wales Court of Appeal[79] in *Vodafone Pacific Ltd v*

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[68] [2001] NSWCA 187.

[69] (1998) 44 NSWLR 349.

[70] [2001] NSWCA 187.

[71] See, eg, *Apple Communications Ltd v Optus Mobile Pty Ltd* [2001] NSWSC 635; *State of New South Wales v Banabelle Electrical Pty Ltd* (2002) 54 NSWLR 503; *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143; *Commonwealth Bank of Australia v Spira* (2002) 174 FLR 274; *Commonwealth Development Bank of Australia Ltd v Cassegraine* [2002] NSWSC 965; *Softplay v Perpetual* [2002] NSWSC 1059.

[72] As noted subsequently by a differently constituted New South Wales Court of Appeal in *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15, [189], [191].

[73] (1998) 44 NSWLR 349.

[74] [2001] NSWCA 187.

[75] Ibid.

[76] Ibid [165].

[77] Ibid [167].

[78] Ibid [166].

[79] Giles, Sheller and Ipp JJA.

Mobile Innovations Ltd.[80] Mobile Innovations Ltd ('Mobile') had been appointed by Vodafone Pacific Ltd ('Vodafone') as a sole or exclusive direct marketing agent under a long term Agent Service Provider ('ASP') contract. Amongst other things, the question arose whether Vodafone was under an implied obligation to act in good faith in exercising its powers under the ASP contract, specifically the power of determining target levels for the acquisition of subscribers. Although the Court of Appeal was ultimately content to assume, expressly without deciding, that there was such an implied obligation,[81] some extremely pertinent observations were made concerning the class of contracts carrying the implied term of good faith as a legal incident.

In discussing the earlier decision of the New South Wales Court of Appeal in *Burger King,*[82] Giles JA[83] observed that the decision fell short of, indeed rejected, treating commercial contracts as a class of contracts carrying the implied term as a legal incident.[84] Giles JA then observed:

> I do not think the law has yet gone so far as to say that commercial contracts are a class of contracts carrying the implied terms as a legal incident, *and the width and indeterminacy of the class of contracts would make it a large step.*[85] (emphasis added)

This is not the first time that judicial doubt has been expressed concerning the selection of the class 'commercial contracts' to carry the implied term of good faith as a legal incident. In *Central Exchange Ltd v Anaconda Nickel Ltd*[86] Parker J similarly stated 'I don't find the notion of all commercial contracts particularly helpful or relevant.'[87]

The decision in *Vodafone Pacific Ltd v Mobile Innovations Ltd*[88] is significant. First, the New South Wales Court of Appeal[89] is clearly seeking to distance itself from any suggestion that *Burger King*[90] should be viewed as authority for the proposition that an implied obligation of good faith is a legal incident of all commercial contracts. Secondly, the decision heralds the need for a careful consideration of contractual context when determining a class of contract that should attract the implied obligation of good faith as a legal incident.[91] This

[80] [2004] NSWCA 15.

[81] Unless excluded by express provision or because inconsistent with the terms of the contract: ibid [191].

[82] [2001] NSWCA 187.

[83] Sheller and Ipp JJA concurred with the judgment delivered by Giles JA.

[84] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15, [189].

[85] Ibid [191].

[86] (2001) 24 WAR 382.

[87] Ibid [21].

[88] [2004] NSWCA 15.

[89] A court which has championed the good faith cause.

[90] [2001] NSWCA 187.

[91] To ensure the class selected is not too broad in its width or indeterminant.

judicial caution has been subsequently echoed both in New South Wales[92] and in other jurisdictions[93] where the appropriateness of good faith being implied an incident of all commercial contracts has been openly questioned.

2.2 The Meaning of 'Good Faith'?

It is one thing to say that an obligation of good faith may be implied in certain commercial contracts; however, there remains the significant difficulty[94] of giving meaning to the implied obligation.[95]

There can be no doubt that a universally accepted definition of the term 'good faith' has proved elusive in the Australian context,[96] as elsewhere.[97] Some consider it unlikely that the term has a fixed meaning.[98] The fact that no one satisfactory definition has evolved should not be viewed as surprising. Perhaps like other fundamental terms applied to human conduct such as 'honesty' or 'malice',[99] 'good faith' (in a similar manner to 'unconscionability') is a term 'better described than defined'.[100]

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[92] See, eg, *Australian Hotels Association (NSW) v TAB Ltd* [2006] NSWSC 293, [78]; *Maitland Main Collieries Pty Ltd v Xstrata Mt Owen Pty Ltd* [2006] NSWSC 1235, [56]; *Ingot Capital Investments v Macquarie Equity Capital Markets [No 6]* [2007] NSWSC 124, [594]. Cf *Mangrove Mountain Quarries Pty Ltd v Barlow* [2007] NSWSC 492, [27].

[93] See, eg, *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [25]; *In Kendells (NSW) Pty Ltd (In Liq) Kendell v Sweeney* [2005] QSC 64, [58] – [59].

[94] The problems in defining 'good faith' were canvassed in *Aiton Australia Pty Ltd v Transfield Pty Ltd* (1999) 153 FLR 236.

[95] There is a wealth of literature concerning the meaning of the term 'good faith'. Reference may be made to numerous Australian articles, see, eg, J W Carter and M P Furmston, 'Good Faith and Fairness in the Negotiation of Contracts' (1994) 8 *JCL* 1 (part 1); (1994) 8 *JCL* 93 (part 2); H K Lucke, 'Good Faith and Contractual Performance' in P D Finn (ed), *Essays on Contract* (1987) 155; E Maloney, 'Contracts and the Concept of Good Faith' (1993) 29 *ACLN* 32; A F Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *LQR* 66; J M Paterson, 'Good Faith in Commercial Contracts? A Franchising Case Study' (2001) 29(4) *ABLR* 270; E Peden, *Good Faith in the Performance of Contracts* (2003); S M Waddams, 'Good Faith, Unconscionability and Reasonable Expectations' (1995) 9 *JCL* 55; D Yates, 'Two Concepts of Good Faith' (1995) 8 *JCL* 145. For an English approach, see, eg, R Brownsword, N Hird and G Howells (eds), *Good Faith in Contract: Concept and Context* (1999). For Canadian commentary, see, eg, M G Bridge, 'Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?' (1984) 9 *Canadian BLJ* 385; D Stack, 'The Two Standards of Good Faith in Canadian Contract Law' (1999) 62 *Saskatchewan Law Review* 201. In the American context, see, eg, S J Burton, 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1980) 94 *Harv Law Review* 369; R S Summers, 'Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code' (1968) 54 *Virginia L Rev* 195; R S Summers, 'The General Duty of Good Faith - Its Recognition and Conceptualization' (1982) 67 *Cornell Law Review* 810.

[96] A Baron, 'Good Faith' and Construction Contracts - From Small Acorns Large Oaks Grow' (2002) 22 *Aust Bar Rev* 54, 54.

[97] In the European context, it has been noted that the term 'good faith' is notoriously difficult to define: James Gordley, 'Good Faith in Contract Law in the Medieval *Ius Commune*' in Reinhard Zimmermann and Simon Whittaker (eds), *Good Faith in European Contract Law* (2000) 93, 93.

[98] *Bropho v Human Rights and Equal Opportunity Commission* (2004) 204 ALR 761, 783-785.

[99] J F O'Connor, *Good Faith in English Law* (1990) 10.

[100] The terminology used by Mahoney JA to describe unconscionability in *Antonovic v Volker* (1986) 7 NSWLR 151, 165: referred to by Mason, above n 2, 89. Some even doubt that the

Even in countries with a large volume of good faith jurisprudence and a considerable body of academic writing, the meaning of the term has proved elusive. In their four volume commentary on the requirement of good faith in the UCC, White and Summers wryly observe 'we caution anyone who is confident about the meaning of good faith to reconsider.'[101] Consistent with this observation, there is a range of academic viewpoints in the United States as to the meaning of the good faith obligation.[102] By way of example, consistent with a conceptualisation that eschews a definitional approach,[103] Professor Summers[104] described the duty of good faith as an 'excluder'. According to Summers' excluder analysis,[105] the phrase 'good faith',

> [i]s a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith. In a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out.[106]

Of course, excluder analysis begets the question: can you define 'bad faith' or merely provide examples of bad faith behaviour? In discussing difficulties of this type, Iglesias refers to an instance where one court characterised bad faith in the same manner that US Supreme Court Justice Potter Stewart famously defined pornography: 'I know it when I see it.'[107]

Given the division of opinion evident in wider good faith jurisprudence from the United States, it is perhaps not surprising that, in *Renard*,[108] Priestley JA made no attempt to define 'good faith'. Priestley JA simply approved the 'excluder' analysis of Professor Summers.[109] However, not all Australian judges or commentators have limited themselves to the excluder analysis that Priestley JA considered to be quite 'workable'.[110] In *South Sydney District Rugby League Football Club Ltd v News Ltd,*[111] Finn J opined that 'good faith' had an identifiable meaning. The implication of a term of good faith was

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term 'good faith' can be defined: Steyn J, 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?' [1991] *Denning LJ* 131, 140.

[101] *Uniform Commercial Code*, Vol 1 (4th ed, 1995) 187 as referred to by P Finn, 'Equity and Commercial Contracts: A Comment' (2001) *AMPLA Yearbook* 414, 420.

[102] E Webb, 'The Scope of the Implied Duty of Good Faith - Lessons from Commercial and Retail Leasing Cases' (2001) 9 *APLJ* 1, 4.

[103] Summers (1982), above n 95, 830.

[104] Writing in the context of the UCC.

[105] An analysis which Summers suggests was first articulated by philosophers, including Aristotle and J L Austin: Summers (1982), above n 95, 827.

[106] Summers (1968), above n 95, 199.

[107] J Iglesias, 'Comment: Applying the Implied Covenant of Good Faith and Fair Dealing to Franchises' (2004) 40 *Hous L Rev* 1423, [1428].

[108] (1992) 26 NSWLR 234.

[109] Summers (1968), above n 95, 196. The same approach was adopted by Byrne J in *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310, [124]. The New South Wales Court of Appeal also cited the excluder analysis in *Burger King* [2001] NSWCA 187, [150].

[110] *Renard* (1992) 26 NSWLR 234, 266.

[111] (2000) 177 ALR 661.

considered to require, at least, that the parties be bound to 'the spirit of the bargain' and not to render illusory contractual entitlements.[112] Other members of the judiciary and academic commentators have favoured the view that good faith operates as a restraint on self-interest at least to the extent that this is unconscionable.[113]

Sir Anthony Mason has observed[114] that good faith may embrace no less than three related notions: an obligation on the parties to cooperate in achieving the contractual objects (loyalty to the promise itself),[115] compliance with honest standards of conduct[116] and compliance with standards of conduct which are reasonable having regard to the interests of the parties.[117] As recently noted by Barrett J, the more substantial and separate meaning of the duty of good faith would seem to lie in the second and third limbs of Sir Anthony's formulation.[118] As these limbs operate to exclude behaviour that exhibits symptoms of 'bad faith' they may be seen as giving effect to the excluder analysis whilst also seeking to give the term 'good faith' an identifiable meaning. Sir Anthony Mason's approach was cited with approval by Finn J in *Hughes*[119] and by Sheller JA in *Alcatel Australia Ltd v Scarcella.*[120] More recently, this approach was also cited with evident approval by the New South Wales Court of Appeal (Sheller, Beazley and Stein JJA) in *Burger King.*[121] However, notwithstanding this support, no definition of 'good faith' has been uniformly agreed upon[122] with the cases demonstrating a 'regrettable lack of uniformity'.[123]

2.3 Basis of the Obligation

The lack of a uniformly agreed definition highlights the significance that must be attached, as in the United States, to the underlying basis of the implied good faith obligation.[124] Is the underlying basis of the obligation the

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[112] Ibid [426].

[113] See, eg, Einstein J in *Aiton Australia Ltd v Transfield Pty Ltd* (1999) 153 FLR 236, 263-265 adopting an approach similar to J Stapleton, [2000] *Current Legal Problems* 1, 5-6. Seddon and Ellinghaus make the comment that such an approach may make it difficult to distinguish good faith from unconscionable conduct: N C Seddon and M P Ellinghaus, *Cheshire & Fifoot's Law of Contract* (8th Aust ed, 2002) 422.

[114] Mason, above n 7, 69.

[115] A duty of cooperation of the *Mackay v Dick* (1881) 6 App Cas 251 variety, as recently affirmed by the High Court in *Peters (WA) Ltd v Petersville* (2001) 75 ALJR 1385.

[116] A subjective requirement.

[117] For a discussion of the issue whether the good faith obligation is tantamount to an obligation to act reasonably in contractual performance and enforcement, see below.

[118] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [64].

[119] (1997) 146 ALR 1, 37.

[120] (1998) 44 NSWLR 349, 367.

[121] [2001] NSWCA 187, [169]-[171].

[122] Peden, above n 35, 159.

[123] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15, [192].

[124] The underlying basis of the good faith obligation will also be critical in the context of potential contractual exclusion of the implied obligation.

reasonable expectations or interests of the contractual parties or is it a much more broadly based notion of community standards?[125]

2.3.1 Reasonable Expectations or Community Standards?

In the past, there is no doubt that a number of academic commentators, who supported the express recognition of an implied obligation of good faith in Australian contract law, commonly envisaged the obligation being based on 'generalised moral standards of fairness, loyalty or cooperation. This approach [was] justified as reflecting community sentiments or ideals[126] about the desirable values in a contractual relationship.'[127] The same approach (with an appeal to moral standards) was reflected in the invocation of community expectations by Priestley JA in *Renard.*[128]

Interestingly, there is very little judicial support for this approach in more recent Australian decisions. In the same way that a good faith obligation allegedly centred on broad moral standards has found less explicit support in decisions in the United States,[129] the prevailing trend of recent Australian lower court authority[130] indicates that the content of the good faith obligation is increasingly likely to be based on the reasonable expectations or legitimate interests of the contractual parties.[131] Serving as but one example, the final conclusions of Barrett J in *Overlook v Foxtel*[132] are instructive:

> Foxtel did not act in a capricious way: on the contrary, its action was deliberate and reasoned and had both a rational basis and an objective explanation. Furthermore, the action was not purely selfish and destructive of the position of Overlook or such as to cause Overlook's rights to become nugatory, worthless or seriously undermined … Foxtel's actions involved no departure from standards of conduct which are honest, as well as being reasonable having regard to the parties' interests.[133]

[125] For further discussion of this particular issue, refer to Paterson, above n 95.

[126] Being the same broad community expectations that are arguably exemplified in legislative initiatives such as s 51AC of the *Trade Practices Act 1974* (Cth): W D Duncan, 'The Implication of a Term of Good Faith in Commercial Leases' (2002) 9 *APLJ* 209, 216.

[127] J M Paterson, 'Limits on a Lender's Right to Repayment on Demand: Construction, Implication and Good Faith?' (1998) 26 *ABLR* 258, 261.

[128] (1992) 26 NSWLR 234, 268.

[129] J M Paterson, 'Duty of Good Faith Does it Have a Place in Contract Law?' (2000) 74 *LIJ* 47, 49.

[130] See, eg, *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349, 367; *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [83]. In *Central Exchange Ltd v Anaconda Nickel Ltd* (2001) 24 WAR 382, Parker J referred to a 'reasonable standard of conduct having regard to the interests of both the plaintiff and the defendant.': at [39].

[131] There is also academic support for this approach given that it abdicates an approach to the implication of good faith based on 'some transcendent vision of fair dealing': Paterson, above n 127, 272.

[132] (2002) Aust Contracts Rep 90-143.

[133] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [83].

2.3.2 Legitimate Interests

In an all but identical vein to treating the parties' reasonable expectations as the underlying basis, the linkage of the basis of the good faith obligation to the legitimate interests of the contractual parties also enjoys a substantial line of academic and judicial support. Finn was one of the first Australian commentators to equate a duty to act in good faith with a positive requirement to have regard to the other contractual party's legitimate interests.[134] In turn this was in recognition of the power that may be wielded within a contractual relationship:

> Relationships, whatever their type, inevitably give to one or both parties the de facto capacity to affect adversely the interests of the other. Expectations can be thwarted, obligations ignored, vulnerability exploited, legitimate interests disregarded, powers exercised harshly, and so on.[135]

Lubbe has also suggested that good faith requires that a measure of recognition and respect be afforded to the legitimate interests of the other party.[136] Peden also proposes a meaning of good faith as a requirement that regard be had of the other party's interests[137] without subordinating one's own interests.[138] Although not in the context of a good faith claim, a similar judicial approach was taken by Mason J[139] in *Hospital Products Ltd v United States Surgical Corp*[140] where he recognised an obligation upon a defendant to have due regard to the plaintiff's interests.[141] This theme was further developed by Sir Anthony Mason when he noted, writing extrajudicially:

> A contract may confer power on a contracting party in terms wider than are necessary for the protection of the legitimate interests of that party. In such a case, the courts will interpret the power as not extending to action proposed by the party in whom the power is vested when that action exceeds what is necessary for the protection of the party's legitimate interests.[142]

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[134] P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) 4 as referred to by J W Carter and M P Furmston, 'Good Faith and Fairness in the Negotiation of Contracts Part 1' (1994) 8 *JCL* 1, 6.

[135] P Finn, 'Commerce, the Common Law and Morality' (1989) 17 *MULR* 87, 95.

[136] Gerhard Lubbe, 'Bona Fides, Billikheid en die Openbare Belang in die Suid-Afrikaanse Kontraktereg (1990) 1 *Stellenbosch LR* 7 as referred to by Dale Hutchison, 'Good Faith in the South African Law of Contract' in R Brownsword, N Hird and G Howells (eds), *Good Faith in Contract: Concept and Context* (1999) 213, 232.

[137] Peden, above n 35, 159.

[138] Ibid 160. Peden, in turn, cites J W Carter and M P Furmston, 'Good Faith and Fairness in the Negotiation of Contracts Part 1' (1994) 8 *JCL* 1, 6.

[139] In a dissenting judgment in so far as it recognised a fiduciary duty (albeit a fiduciary duty that was limited in its scope).

[140] (1984) 156 CLR 41.

[141] Ibid 101.

[142] Mason, above n 7, 76.

More recently, this approach has received the express support of Barratt J who opined that good faith involves 'a duty to recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.'[143]

For the purposes of this paper, it is suggested that the difference between 'reasonable expectations' and 'legitimate interests' as the underlying basis of the implied obligation of good faith is mere semantics. Considerable support for this proposition is garnered from the approach of Finn J to use these two terms interchangeably.[144] Yee also notes that the determination of legitimate interests must be substantially tied to reasonable expectations of contractual behaviour.[145] For this reason, from this point on, any individual reference in this research to the term 'reasonable expectations' is to be treated as being synonymous with the term 'legitimate interests'. What is most significant for this research is the highlighted trend to use these bases in clear preference to Priestley JA's invocation of 'community expectations'.

Unfortunately, the recognition of the parties' reasonable expectations, as the generally prevailing basis of the good faith obligation in Australia, does not mean that the content of the obligation can be stated with absolute certainty. As with the Restatement, there seems little doubt that the content of the good faith obligation in any particular instance will depend on the 'circumstances of the case and upon the context of the whole of the contract.'[146] In this regard, the observation has been made[147] that the content of the good faith obligation is perhaps best determined on a case by case basis using the broad discretion of the trial judge.[148] While individual cases will provide guidance, the critical issue will be the reasonable expectations that are engendered in the relevant contractual context. The parties' contractual relationship is the source from which the implied good faith obligation draws its content.[149] This approach is not without its advantages.

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[143] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [67]. The same approach was adopted by Hasluck J in *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [388] and by Dodds-Stretton J in *Varangian v OFM Capital Limited* [2003] VSC 444, [175]. Consistent with the need to have regard to the interests of both parties, in *Hoppers Crossing Club Ltd v Tattersalls Gaming Pty Ltd* [2005] VSC 114, Kaye J opined that the implied term of good faith 'would not operate so as to preclude the right of a party to act in pursuit of its own legitimate commercial interests.': at [25].

[144] Notwithstanding that Finn J has recently expressed a preference for an approach based on reasonable expectations: Finn J, 'Good Faith and Fair Dealings and 'Boats Against the Current'' (Paper presented at the Second Biennial Conference on the Law of Obligations, Melbourne, 16 July 2004) 10.

[145] W P Yee, 'Protecting Parties' Reasonable Expectations: A General Principle of Good Faith' [2001] 1(2) *OUCLJ* 195, 223.

[146] *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [148]. See also S K O'Byrne, 'Good Faith in Contractual Performance: Recent Developments' (1995) 74 *Canadian Bar Review* 70, 73.

[147] In the context of a requirement that the parties utilise dispute resolution procedures in good faith.

[148] *Aiton Australia Pty Ltd v Transfield Pty Ltd* (1999) 153 FLR 236, [129] (Einstein J).

[149] *Forklift Engineering Australia Pty Ltd v Powerlift (Nissan) Pty Ltd* [2000] VSC 443.

To use the words of Finn J, an approach of this type[150]

> has the virtue of conditioning the inquiry by reference to the actual circumstances of a given relationship: its nature, its terms, its contemplated purposes, the relative positions of the parties, the actual progress of the relationship, its business setting, the reasons for a decision or action taken, the consequences of the decision or action, and so on. Such is the material from which one will determine what, in the circumstances, one party is reasonably entitled to expect of the decision or action of the other. … If the inquiry so raised is individualized, it is neither amorphous or unmanageable. Its focus ordinarily will be no more than whether one party's conduct is consistent with (or faithful to) the relationship of the parties that is evidenced by their contract.[151]

2.4 Is the Good Faith Obligation Tantamount to an Obligation to act Reasonably in Contractual Performance and Enforcement?

There has been a tendency by some members of the Australian judiciary to equate the notions of good faith and reasonableness.[152] Notwithstanding this tendency, in practice, the application of the good faith standard has not been as onerous as would be expected if good faith were truly equated with a requirement of contractual behaviour that would be objectively regarded as reasonable.[153] In other words, in its practical application, the good faith obligation has not been considered to be breached simply because a party to a contract has acted in a manner that could be objectively viewed as unreasonable. A few examples will serve to demonstrate this proposition.

The mere fact that the exercise of a contractual right (for example a right to terminate) happened to accord with the innocent party's commercial objectives has not been regarded as sufficient to establish bad faith.[154] Indeed it has been noted that the implied duty of good faith does not require a party to subordinate its contractual rights.[155] Similarly, Finkelstein J made the point in *Garry Rogers Motors Aust Pty Ltd v Subaru (Aust) Pty Ltd*[156] that the presence of an implied term of good faith does not restrict a party acting so as to promote its own 'legitimate interests'.[157] If an objective requirement of acting in a contractually reasonable manner were truly part of the good faith standard there would be an expectation that these judicial comments would be subject to a further 'reasonableness' caveat which has not been apparent.

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[150] Based on reasonable expectations.

[151] Finn, above n 144, 10-11.

[152] As noted by Hasluck J in *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [388].

[153] As noted by Stapleton, a requirement of good faith is not nearly as onerous as a requirement of objectively reasonable behaviour: J Stapleton, 'Good Faith in Private Law' (1999) 52 *CLP* 1, 8.

[154] Refer to comments to this effect by Gyles J in *Asia Television Ltd v Yau's Entertainment Pty Ltd* (2000) 48 IPR 283, [77].

[155] Per Barrett J in *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [65].

[156] (1999) ATPR 41-703.

[157] Ibid [37]. This approach was recently cited with approval by Kaye J in *Hoppers Crossing Club Ltd v Tattersalls Gaming Pty Ltd* [2005] VSC 114, [25].

From the available decisions, the conclusion that may be drawn is that, to act reasonably, is to act in good faith.[158] This very point was made by Finkelstein J in *Garry Rogers Motors Aust Pty Ltd v Subaru (Aust) Pty Ltd*[159] when His Honour observed that 'provided the party exercising the power acts reasonably in all the circumstances the duty to act fairly and in good faith will ordinarily be satisfied.'[160] However, to act unreasonably, is not, of itself, tantamount to a failure to act in good faith due to a party's right to have regard to its own interests. 'A party may have behaved in good faith, yet still have behaved unreasonably.'[161]

For these reasons, it is hard not to agree with the observation that the judicial equation of 'an obligation of reasonableness and one of good faith is misconceived'[162] and further that 'the New South Wales Court of Appeal in *Burger King* is incorrect in assimilating good faith with objective reasonableness, as reasonableness sets too high a standard.'[163] The better view is that, although there may be a degree of overlap in their content, the terms 'unreasonableness' and 'lack of good faith' should continue to be employed in different contexts and should not be treated as co-extensive in their connotations.[164]

2.5 Should Good Faith be Equated to a Fiduciary Standard? What is the Relevance of Self-Interest?

The possibility of good faith being equated to a fiduciary standard has raised concerns for certain commentators[165] and is, undoubtedly, an issue that requires clarification.[166] By way of background, in the 1980s it was not uncommon for Australian commercial plaintiffs to allege that the relationship was a fiduciary one, rather than one simply regulated by the terms of the contract, either express or implied. The motivation for a fiduciary plea was often the desire to obtain a gain-based remedy[167] rather than a loss-based remedy.[168] However, this 'great experiment'[169] was largely defused by the High Court. In *Breen v Williams*[170] the High Court observed that a general

[158] *Lay v Alliswell Pty Ltd* (2002) V Conv R 54-651, [31].

[159] (1999) ATPR 41-703.

[160] *Garry Rogers Motors Aust Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703, [37].

[161] Peden, above n 35, 164.

[162] Ibid 163.

[163] Ibid 184.

[164] An observation consistent with that of Hasluck J in *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [352].

[165] See, eg, J W Carter and A Stewart, 'Interpretation, Good Faith and the "True Meaning" of Contracts: The Royal Botanic Decision' (2002) 18 *JCL* 182, 194.

[166] Ibid.

[167] This was the motivation for the plea in *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41.

[168] Loke, above n 46, 539.

[169] Tyrone M Carlin, 'The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25(1) *UNSWLJ* 99, 101.

[170] (1996) 186 CLR 71.

fiduciary relationship will not arise simply due to a contractual relationship having some fiduciary aspects. Due to this judicial approach, Australia has been kept relatively immune from 'an unprincipled penetration of the fiduciary principle into ordinary contractual dealings.'[171]

While it is understandable that a plaintiff may wish to pursue a fiduciary claim,[172] is it correct to regard the concepts of good faith and fiduciary obligations as being closely intertwined? Although it is clear that the categories of fiduciary relationships are not closed,[173] the central nature of a fiduciary relationship must be borne in mind:

> The critical feature of these [i.e. fiduciary] relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.[174]

As noted by Meagher, Heydon and Leeming:

> The distinguishing characteristic of a fiduciary relationship is that its essence, or purpose, is to serve exclusively the interests of a person or group of persons; or, to put it negatively, it is a relationship in which the parties are not each free to pursue their separate interests.[175]

Despite concerns that the two concepts of good faith and fiduciary obligations may somehow be interwoven, it is clear from a number of Australian decisions concerning good faith that an allegation of self-interest (that would not be permissible in a fiduciary relationship) will not be sufficient, of itself, to sustain a claim based on breach of the good faith obligation. A clear example is provided by the New South Wales Court of Appeal in *Burger King*[176] when it was noted:

> That does not mean that BKC is not entitled to have regard only to its own legitimate interests in exercising its discretion. However, it must not do so for a purpose extraneous to the contract - for example, by withholding financial or operational approval where there is no basis to do so, so as to thwart HJPL's rights under the contract.[177]

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[171] P Finn, 'Contract and the Fiduciary Principle' (1989) 12 *UNSWLJ* 76, 82. Empirical analysis of decisions since *Breen v Williams* suggests that those seeking to impose fiduciary standards outside recognised categories will be disappointed: Carlin, above n 169, 102.

[172] For some of the practical and procedural advantages of a fiduciary claim refer to Loke, above n 46, 539-541.

[173] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 68 (Gibbs CJ), 96-97 (Mason J), 141-142 (Dawson J).

[174] Ibid 96-97 (Mason J).

[175] R P Meagher, J D Heydon and M J Leeming, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (4th ed, 2002) 158.

[176] [2001] NSWCA 187.

[177] Ibid [185].

The issue was directly addressed by Barratt J in *Overlook v Foxtel*[178] when discussing the implied obligation of good faith:

> But no party is fixed with the duty to subordinate self-interest entirely which is the lot of the fiduciary … The duty is not to prefer the interests of the other contracting party. It is, rather, a duty to recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.[179]

As these quotations clearly indicate, contractual behaviour that would not be permissible in a fiduciary relationship will not necessarily infringe an implied obligation of good faith as the fiduciary standard is the highest protective responsibility which the law imposes on consensual relationships.[180]

In essence, to equate good faith with a fiduciary standard is to make a fundamental mistake, both as to the incidence and the content of the two obligations. As noted, to invoke proscriptive, fiduciary duties is to seek the highest degree of protective responsibility.[181] This level of protective responsibility will be a rarity in commercial relationships by contrast to implied obligations of good faith which will frequently arise. However, although far more frequent in their occurrence, the obligations arising due to an implied obligation of good faith are far less onerous than those owed in a fiduciary relationship.[182]

2.6 What Correlation is There (if any) Between Good Faith and Equitable and/or Statutory Unconscionability?

Certain academics seek to equate the notions of good faith and unconscionability[183] or, at the very least, seek to suggest that the standard of conduct which will result in a breach of the implied duty of good faith is unconscionability.[184] This approach is not without judicial support. In *Renard*,[185] Priestley JA referred to the close association of ideas between the terms unreasonableness, lack of good faith and unconscionability.[186] In

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[178] (2002) Aust Contracts Rep 90-143.

[179] Ibid [67].

[180] Loke, above n 46, 542.

[181] Loke, above n 46, 544.

[182] Consistent with the observation of Hollingworth J in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2004] VSC 477, [126] that good faith imposes a narrower and less onerous standard than that required of fiduciaries.

[183] See, eg, Stapleton, above n 153. Clough also argues that there is a trend to a general duty of good faith based upon a broad notion of unconscionability: D Clough, 'Trends in the Law of Unconscionability' (1999) 18 *Aust Bar Rev* 34. Cf Finn who describes the good faith standard as falling between the unconscionability standard and the fiduciary standard: see P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) 3-4 (referred to by Peter Heffey, Jeannie Paterson and Andrew Robertson, *Principles of Contract Law* (2002) 262).

[184] E Webb, 'The Scope of the Implied Duty of Good Faith – Lessons from Commercial and Retail Leasing Cases' (2001) 9 *APLJ* 1, 3.

[185] (1992) 26 NSWLR 234.

[186] Ibid 265.

Alcatel Australia Ltd v Scarcella[187] the New South Wales Court of Appeal seemed to equate unconscionability with a breach of the good faith obligation.[188] In a similar manner, in *Dickson Property Management Services Pty Ltd v Centro Property Management (Vic) Pty Ltd*[189] it was noted that the implied obligation of good faith may be breached if the actions were unreasonable, capricious or unconscionable.[190] By way of a final example, in *Automasters Australia Pty Ltd v Bruness Pty Ltd*[191] Hasluck J suggested that good faith was probably no more than a prohibition on acting unconscionably.[192]

2.6.1 Different Meanings of the Term 'Unconscionability'

A difficulty with the term 'unconscionability' is that it is not employed by either academics or the judiciary in a uniform manner.[193] Perhaps influenced by statutory developments dealing with unconscionable conduct,[194] it is not uncommon in this regard for academics to ascribe their own broad meanings to the term 'unconscionability'. For example, one academic approach seeks to delineate the boundaries of good faith conduct by suggesting that contractual self-interest may be pursued to a point where it becomes unconscionable for certain specific reasons.[195]

By way of judicial example, Priestley JA in *Renard*[196] opined that statutes proscribing unfair and unconscionable transactions could be used to bolster the development of a common law good faith obligation.[197] Clearly in this instance, the term 'unconscionability' was not being used by Priestley JA[198] to indicate the specific, equitable doctrine but rather the broader, generic meaning of unconscionability, being conduct that is regarded, in equity, as being against conscience, thus providing the basis for equitable intervention in a variety of circumstances. It is suggested, with respect, that the use of the broader, generic meaning of 'unconscionability' has merely created

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[187] (1998) 44 NSWLR 349.

[188] Ibid 369.

[189] (2000) 180 ALR 485.

[190] (2000) 180 ALR 485, 487.

[191] [2002] WASC 286.

[192] *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [372].

[193] In the context of the debate concerning discretionary remedialism, the word 'unconscionable' has been described as so unspecific that it simply conceals private and intuitive evaluation: P Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 *UWALRev* 1, 16-17.

[194] See below.

[195] Stapleton, above n 153, 7-8. Clough also expressly gives unconscionability a much broader meaning than that traditionally ascribed in equity: Clough, above n 183, 53-54.

[196] (1992) 26 NSWLR 234.

[197] Ibid 268.

[198] Writing extra-judicially, Priestley JA clearly distinguished good faith and unconscionability: Hon J Priestley, 'Contract - The Burgeoning Maelstrom' (1988) 1 *JCL* 15, 19-22, 28-29 (as referred to by Peden, above n 2, 169). See, also, E Peden, 'Contractual Good Faith: Can Australia Benefit From the American Experience?' (2003) 15 *Bond LR* 175, 189.

unnecessary confusion in the good faith debate. This confusion largely disappears when the term 'unconscionability' is used to refer to the specific equitable doctrine that is recognised in its own right. The statutory treatment of unconscionability is considered separately.

2.6.2 The Equitable Doctrine of Unconscionability

The longstanding equitable doctrine of unconscionability was 'invigorated'[199] by the High Court in *Commercial Bank of Australia v Amadio*.[200] As stated by Mason CJ, relief will be available where:

> a party makes unconscientious use of his superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage ... the will of the innocent party, even if independent and voluntary … is the result of the disadvantageous position in which he is placed and of the other party unconscientiously taking advantage of that position.[201]

In these circumstances, 'an onus is cast upon the stronger party to show the transaction was fair, just and reasonable.'[202] The equitable doctrine of unconscionability is intended to preclude advantage being taken of a person labouring under a disability such as, but not limited to, 'poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary.'[203] The limitations of the equitable doctrine were explicitly acknowledged by the High Court in *Louth v Diprose*:[204]

> Although the concept of unconscionability has been expressed in fairly wide terms, the courts are exercising an equitable jurisdiction according to recognised principles. They are not armed with a general power to set aside bargains simply because, in the eyes of the judges, they appear to be unfair, harsh or unconscionable.[205]

Given this limitation, and the attendant requirement of a special (or serious) disadvantage, it is submitted that the specific equitable doctrine of unconscionability may be clearly distinguished from the common law implied obligation of good faith, as it may impact upon the performance and enforcement of commercial contracts. As exemplified by *Commercial Bank of Australia v Amadio*,[206] the focus of the equitable doctrine of unconscionability is upon procedural or constitutional disability[207] arising at, or prior to, the time

[199] Sir Anthony Mason, 'Changing the Law in a Changing Society' (1993) 67 *ALJ* 568, 571.

[200] (1983) 151 CLR 447.

[201] *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, 461

[202] Ibid 474 (Deane J).

[203] *Blomley v Ryan* (1956) 99 CLR 362, 405 (Fullagar J).

[204] (1992) 175 CLR 362.

[205] *Louth v Diprose* (1992) 175 CLR 621, 654 (Toohey J).

[206] (1983) 151 CLR 447.

[207] Mistaken commercial judgment, without more, will not constitute a constitutional disability: *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd* (2002) 189 ALR 76, [64]-[65].

of contract formation as it impacts on whether a contract may be set aside.[208] Consistent with the observation that the equitable doctrine does not focus on substantive unconscionability,[209] the equitable doctrine falls to be considered in the formation of a contract rather than its termination.[210] As demonstrated by *Tri-Global (Aust) Pty Ltd v Colonial Mutual Life Assurance Society Ltd*,[211] the equitable doctrine of unconscionability will not generally have any application to the conduct of parties occurring after the formation of an ongoing contractual relationship.[212] In contrast, the province of the implied obligation of good faith is to temper the pursuit of self-interest following contract formation.

Further, even in the context of contract formation, the specific equitable doctrine of unconscionability is less likely to have application to parties to arm's length commercial transactions as the requisite 'special disability' will be infrequently present and parties will often have professional assistance.[213] In *Overlook v Foxtel*[214] a claim based on the equitable doctrine was raised, amongst others, in a commercial context. The claim was quickly dismissed:

> It can be said at once that there is no scope for the operation of these principles in the present case of a contract negotiated at arm's length between corporations represented by commercial negotiators … and having the active and ongoing assistance of their respective lawyers. To the extent that a claim based on ordinary equitable notions of unconscionable dealing is seriously asserted by Overlook, it simply cannot be sustained in the particular commercial context.[215]

In contrast, the good faith obligation in contractual performance and enforcement will frequently be implied in contracts involving arm's length transactions, often between sophisticated businesspersons.[216] Unlike the equitable doctrine of unconscionability, there is scope for the operation of the implied obligation of good faith in contractual performance and enforcement regardless of the relative bargaining strengths of the parties to the commercial contract.

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[208] *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 197 ALR 153, 165 (Gummow and Hayne JJ). See, also, F Zumbo, 'Unconscionability Within a Commercial Setting: An Australian Perspective (1995) 3 *TPLJ* 183, 193. The non-application of the equitable doctrine post-contract formation has attracted criticism. See, eg, J Swan, 'Party Autonomy and Judicial Intervention: The Impact of Fairness in Commercial Contracts' (1994) 7 *JCL* 1, 18.

[209] Anthony J Duggan, 'Is Equity Efficient?' (1997) 113 *LQR* 601, 612. In United States jurisprudence, this distinction (between procedural and substantive unconscionability) is often referred to as the difference between 'bargaining naughtiness' and 'the inherent substantive unfairness of a disputed term': R J Mooney, 'Hands Across the Water: The Continuing Convergence of American and Australian Contract Law' (2000) 23(1) *UNSWLJ* 1, 28.

[210] Clough, above n 183, 38.

[211] (1992) ATPR 41-174.

[212] Clough, above n 183, 38.

[213] Cf *Asia Pacific International Pty Ltd v Dalrymple* [2000] 2 Qd R 229.

[214] (2002) Aust Contracts Rep 90-143.

[215] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [93].

[216] Burton, above n 95, 372, 383.

At an international level, it is noteworthy that in both the *Principles of European Contract Law* and the *Unidroit Principles* 2004, in addition to the good faith duty, there are quite separate provisions dealing with the issue of unconscionability. Cognisant of these international provisions, Finn has observed that the unconscionable dealings doctrine 'cannot be seen as a substitute for the good faith and fair dealing obligation itself.'[217] Similarly, in the United States, where the UCC also has separate provisions addressing unconscionability,[218] Burton has noted that the good faith performance doctrine should be sharply distinguished from the doctrine of unconscionability.[219] It is suggested, with respect, that these sentiments are equally applicable in the Australian context, where a sharp distinction should be drawn between the equitable doctrine of unconscionability and common law obligation of good faith for the reasons outlined.

Having made this distinction, it is still necessary to consider separately the possible intersection between the broader statutory treatment of unconscionability and the common law implied obligation of good faith.

2.6.3 Statutory Unconscionability

One of the most well known statutory provisions dealing with unconscionability[220] is s 51AC(1) of the *Trade Practices Act 1974* (Cth).

In determining if a supplier or acquirer has engaged in unconscionable conduct for the purposes of these sections, the court is entitled to have regard to a non-exhaustive list of matters as specified in s 51AC(3). Given the breadth of this list of matters, it has been accepted that s 51AC is not limited to the equitable doctrine of unconscionability of the *Commercial Bank of Australia v Amadio*[221] type[222] and is wider than the concept of unconscionable conduct 'within the meaning of the unwritten law … ' as regulated by s 51AA of the *Trade Practices Act 1974* (Cth).[223] The wording of the section is clearly intended to prohibit broadly unconscionable conduct in the range of transactions to which it is applicable.[224]

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[217] Finn, above n 101, 419.

[218] UCC 2-302 (1) provides (in part): If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract.

[219] Burton, above n 95, 371.

[220] There are many other statutory provisions, see, eg, *Australian Securities and Investments Commission Act 2001* (Cth), s12CC; *Retail Shop Leases Act 1994* (Qld), s 46B(1).

[221] (1983) 151 CLR 447.

[222] See, eg, *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [361].

[223] See, eg, *Silver Fox Company Pty Ltd v Lenard's Pty Ltd* [2004] FCA 1225, [219]. Section 51AA does not apply to conduct that is prohibited by s 51AB or s 51AC: *Trade Practices Act 1974* (Cth) s 51AA(2).

[224] *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [361].

One of the listed matters that the court may have regard to,[225] is the extent to which the supplier or acquirer acted in good faith.[226] There is no definition in the *Trade Practices Act 1974* (Cth) of the term 'good faith'. One commentator has even observed that s 51AC has thrust a good faith obligation on us by stealth![227] A key issue in the application of the provision will be whether the test of 'good faith' is subjective, objective, or possibly an amalgam of both. Unfortunately as a matter of statutory interpretation, as Corones has observed, having regard to the other factors set out in s 51AC(3) and (4) it is not possible to reach a conclusion on this issue.[228]

Finn suggests that the absence of the additional words 'and fair dealing' after the words 'good faith' may limit the operation of good faith in this particular statutory context to subjective considerations of honesty only, rather than the additional obligation of requiring conduct that may be considered objectively to be reasonable.[229] In the more general good faith context, Sir Anthony Mason has also drawn attention to the added significance of the words 'fair dealing'.[230] Peden also takes the view that the use of 'good faith' in s 51 AC could simply mean 'honesty' or a 'lack of ill will' as is the case in many other pieces of legislation.[231]

For the purposes of this paper, it is in the area of contractual performance and enforcement that the interplay between s 51AC and a common law claim based on breach of a good faith obligation needs to be considered. A recent decision that involved arguments based on breach of an express good faith obligation and breach of s 51AC of the *Trade Practices Act 1974* (Cth) is *Automasters Australia Pty Ltd v Bruness Pty Ltd*.[232] As a rare example of where relief was considered available under both heads of claim, the decision is significant and warrants further examination.

Automasters Australia Pty Ltd ('Automasters'), as franchisor, alleged that Bruness Pty Ltd ('Bruness'), as franchisee, was in breach of a franchise agreement relating to the operation of an automotive service business. The alleged breaches were principally referable to an obligation to maintain the data entry system, which in turn enabled the franchisor to ensure the proper

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[225] Although there are twelve criteria listed, the Full Federal Court has made it clear that it distorts the proper operation of the section to search through the twelve criteria, find a criterion that seems apposite, and then make a conclusion of unconscionable conduct. In any given instance, some of the stipulated criteria may tell against a finding of unconscionable conduct. Further, the criteria do not limit the matters to which the court may have regard: *Australian Competition and Consumer Commission v Oceana Commercial Pty Ltd* [2004] FCAFC 174, [181].

[226] Section 51AC(3)(k) and s 51AC(4)(k) of the *Trade Practices Act 1974* (Cth).

[227] Finn, above n 101, 421.

[228] S Corones, 'Does 'Good Faith' in s 51AC of the Trade Practices Act Deny Self-Interest?' (1999) 27 *ABLR* 414, 415.

[229] Finn, above n 101, 421.

[230] Mason, above n 7, 76.

[231] Peden, above n 35, 169,190.

[232] [2002] WASC 286.

amount of royalties was being paid under the franchise agreement. Bruness maintained that problems with the data entry system were due to the quality of the computer system installed on behalf of Automasters and, in particular, the inability of the computer software to operate efficiently.[233]

Automasters purported to terminate the franchise agreement and sought damages and other curial relief. By way of counterclaim, Bruness sought, amongst other things, a declaration that the franchise had not been terminated, damages for breach of contract and damages under the *Trade Practices Act 1974* (Cth). Bruness claimed that the conduct of Automasters was unconscionable under s 51AC of the *Trade Practices Act 1974* (Cth) and also contravened clause 15.1 of the franchise agreement. Clause 15.1 obliged Automasters, as franchisor, to use its best endeavours to promote the performance and success of the franchise business and to deal with the franchisee in absolute good faith. It was not in dispute that effect could be given to an express contractual term concerning good faith, even though the content of the express term may be a matter for individual determination.[234]

In particular, Bruness alleged that Automasters' actions were a manifestation of its determination to bring the franchise agreement to an end for reasons other than breaches of the contractual relationship. It was alleged that Automasters was not motivated by a desire to protect its legitimate interests but by malice and/or revenge[235] due to deterioration in the parties' relationship. In making this allegation, matters that were relied upon included:

- Automasters' resentment of Bruness' frequent criticism of the computer hardware and software supplied by Automasters;

- the insistence of Bruness that a former employee should be dismissed by Automasters and charged with a criminal offence;

- complaints by Bruness to the Australian Competition and Consumer Commission that Automasters had acted unconscionably;

- a refusal by Automasters to supply Bruness with a copy of a report relating to quality assurance certification, being a report relied upon by Automasters to issue a default notice;

- Automasters' purported termination of the franchise agreement notwithstanding that the quality assurance auditor's report did not terminate the accreditation of Bruness; and

- the refusal of Automasters to entertain a request for mediation pursuant to Part IV of the *Franchising Code of Conduct*.[236]

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[233] Ibid [110].
[234] Ibid [140].
[235] Ibid [121].
[236] Ibid [122]-[123].

Bruness further contended that Automasters used the threat of termination in an attempt to force Bruness to dispose of the franchise to Automasters for a price well below its true market value.[237]

Due to the presence of the express provision concerning good faith in the franchise agreement, it was unnecessary for Hasluck J to determine whether an obligation of good faith should be implied. Nevertheless, the findings of the court are helpful in delineating the nature of the good faith obligation and the operation of s 51AC of the *Trade Practices Act 1974* (Cth). In determining whether a party had acted in good faith, Hasluck J observed that this might require the court to give some consideration to the motives of that party.[238]

Having examined all the circumstances, Hasluck J concluded that the relevant officers of Automasters were looking for ways and means of bringing the franchise to an end (as was the case in *Australian Competition & Consumer Commission v Simply No-Knead (Franchising) Pty Ltd*).[239] Their actions in issuing a notice of default, in circumstances where this was not contemplated by the quality assurance report, and where there was considerable doubt concerning the reliability of various data entry non-compliance lists, were unreasonable and capricious.[240] Their failure to have regard to the legitimate interests of the franchisee amounted to oppressive conduct[241] entitling Bruness to relief for breach of the express good faith term.

For substantially the same reasons that supported a finding of a lack of good faith, Hasluck J characterised Automasters' conduct as unconscionable within the meaning of s 51AC of the *Trade Practices Act 1974* (Cth). The misconduct complained of was 'serious, unfair and oppressive and showed no regard for conscience.'[242] Hasluck J was not prepared to regard this as a case where the franchisor had simply acted in accordance with its contractual rights.[243] Hasluck J made the following important observation concerning the interaction between contractual good faith and s 51AC unconscionability:

> The notion of unconscionable conduct may not be co-extensive with conduct conforming to the requirement to act in good faith but conduct which is held to be unconscionable within the meaning of s 51AC of the *Trade Practices Act* will probably be sufficient to constitute a breach of an express term providing for absolute good faith between the parties.[244]

It is submitted, with respect, that this observation is undoubtedly correct but that any analysis that seeks to equate a lack of good faith with

[237] Ibid [385].

[238] Ibid [148]. Hasluck J cited, with approval, an observation to this effect by W D Duncan in 'The Implication of a Term of Good Faith in Commercial Leases' (2002) 9 *APLJ* 209: ibid [146].

[239] (2000) 178 ALR 304.

[240] *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [391].

[241] Ibid [393].

[242] Ibid [399].

[243] Ibid.

[244] Ibid [388].

unconscionability, rather than vice versa, must be approached with great caution. Although, in the particular factual circumstances encountered by Hasluck J, the franchisee successfully placed reliance on both claims; this is one of few decisions to this effect. Further, it must be recognised that the franchisor's breach of the requirements of the *Franchising Code of Conduct*[245] was a factor specifically taken into account (in accordance with s 51AC(3)(g) of the *Trade Practices Act 1974* (Cth)) in reaching a conclusion that the conduct complained of was unconscionable. For this reason, it is submitted that the decision is best characterised as an example of particular unconscionable conduct that also demonstrated a lack of good faith, rather than supporting any hypothesis strictly equating a lack of common law good faith with statutory unconscionability.

3. Matters for Consideration by Commercial Advisers

3.1 Motive

The issue of contractual motive will often be a fundamental one in good faith disputes and it is an issue on which opinions inevitably vary.[246] The traditional 19th century common law approach (to an exploration of motive) is well illustrated by Will J who opined that a right given by a contract to one party may be exercised against the other 'no matter how wicked, cruel, or mean the motive may be which determines the enforcement of the right.'[247] Prior to the advent of current Australian good faith jurisprudence, similar views had been expressed by members of the Australian judiciary. In *Champtaloup v Thomas*[248] Glass JA warned that the danger of a requirement that the exercise of a contractual power had to be actuated by a legitimate purpose was that it would involve a 'judicial trek through a quagmire of mixed motives.'[249] Similarly, Beaumont J in *Amann Aviation Pty Ltd v Commonwealth*[250] held that if powers are exercised in accordance with the terms of the contract, there is no requirement that their exercise be actuated by a 'legitimate purpose', and the motive of one party in exercising the contractual power is irrelevant.[251] Given these traditional approaches, the observation that common law lawyers are reluctant 'to commit themselves to forensic inquiries into motivation'[252] seems apposite.

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[245] A code to regulate the conduct of participants in franchising.

[246] See, eg, I B Stewart, 'Good Faith in Contractual Performance and in Negotiation' (1998) 72 *ALJ* 370.

[247] *Allen v Flood* [1898] AC 1, 46. This traditional view continues to be followed in English common law. As recently noted by Finkelstein J (in turn citing Professor Goode), 'the English take the view that legal rights can be exercised regardless of motive.': *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288, [61].

[248] [1976] 2 NSWLR 264.

[249] *Champtaloup v Thomas* [1976] 2 NSWLR 264, 271.

[250] (1988) 80 ALR 35.

[251] *Amann Aviation Pty Ltd v Commonwealth* (1988) 80 ALR 35, 38. It is acknowledged that the material in this paragraph is derived from the article of Stewart, above n 246, 371.

[252] H K Lucke, 'Good Faith and Contractual Performance' in P D Finn (ed), *Essays on Contract* (1987) 155, 182.

However, the advent of the good faith obligation has brought with it a judicial recognition in Australia that a court may now be required to examine the motivation underlying the exercise of contractual rights.[253] In turn, this will have implications for commercial parties and their advisers concerning the ambit of acceptable commercial contractual behaviour.

3.2 What is Permissible and What is Not?

Consistent with earlier comments, a party to a commercial contract is not required to act in a contractually altruistic manner or in a manner akin to a fiduciary. Express provision aside, a commercial client is not required to subordinate their own immediate or longer-term business or other interests to those of the other party.[254] An obligation of good faith still allows the parties to retain their economic autonomy or economic liberty.[255] Although not strictly required to demonstrate that any decision accords with a 'business judgment' approach or 'future business needs',[256] if the exercise of a contractual discretion or power has both an honest basis and an explanation that is in accordance with the reasonable expectations of both contractual parties[257] it is unlikely to be contrary to the implied obligation of good faith.[258]

The most common allegation of conduct contrary to a good faith requirement will require the court to examine the motive for the exercise of a contractual right to determine if the right is being exercised 'capriciously or for some extraneous purpose.'[259] Consistent with previous observations, it is suggested that a contractual right will be exercised capriciously where there is no rational basis for the exercise of the right or no explanation for the exercise of the right[260] that is in accordance with the parties' reasonable expectations. The selfish exercise of a contractual right calculated to destroy the contractual position of the other party to the contract may well be contrary to the implied obligation of good faith.[261] Nevertheless, to succeed in a claim of this type, the plaintiff will need to produce compelling evidence of motive.

As was the case in *Far Horizons Pty Ltd v McDonald's Australia Ltd*[262] an argument based on inference, rather than evidence of substance, is unlikely to succeed. Where compelling proof is available that the sole or dominant

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[253] See, eg, *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, [353].

[254] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [65]; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2004] VSC 477, [130].

[255] *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* [2007] NSWSC 104, [112].

[256] To adopt language used by Lockhart J in *Gallagher v Pioneer Concrete (NSW) Pty Ltd* (1993) ATPR 41-216, 40,991.

[257] For example, if the decision may be justified by reference to the common welfare of the parties: *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [98].

[258] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [83].

[259] *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310, [120].

[260] *Overlook v Foxtel* (2002) Aust Contracts Rep 90-143, [73].

[261] Ibid.

[262] [2000] VSC 310.

demonstrated motive of a party to a commercial contract was for a purpose totally inimical to the reasonable expectations of the contractual parties, the prospects of successful reliance on the implied term will increase dramatically. For example, a franchisor's conduct that is deliberately calculated to damage the franchisee's business will be regarded as inconsistent with a proper relationship between franchisor and franchisee and will be demonstrative of a lack of good faith.[263]

3.3 Contractual Exclusion - Avoiding the Argument?

Given the many unresolved issues concerning the operation of the implied obligation of good faith in contractual performance and enforcement, by necessity, commercial advisers will consider the possibility of either express or implied contractual exclusion, where a good faith obligation may otherwise be implied. This is an issue that I have considered at length elsewhere.[264] For present purposes, it will suffice to simply restate some of the conclusions reached as part of that earlier analysis.

If an 'opting out' clause is 'precise, specific, not antithetical to the entire purpose or intent of the remainder of the contract, and is not unconscionable or contrary to public policy it ought to be enforceable.'[265] To be an effective 'opting out' clause, it will be prudent to say expressly that the implied obligation of good faith does not apply to the extent that the implied obligation may limit the rights otherwise lawfully available under the terms of the contract or at law. Another approach would be to state clearly that:

> the discretionary right in question [as the case may be] is not subject to the expectations, 'reasonable or otherwise,' of the parties to the contract and that any action taken pursuant to the provision is 'deemed to be exercised in good faith.'[266]

As Grover has commented:

> The courts are not ready to read down freedom of contract explicitly if you can avoid the illegality and public policy arguments and your client does not have the status of fiduciary. A clear clause will embarrass the judiciary into submission …[267]

As indicated by this quotation, although express 'opting out' of the implied good faith obligation appears to be contractually possible, this is not to suggest that every 'opting out' clause will be upheld. Consistent with public policy concerns about provisions condoning dishonesty, a clause which

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[263] *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000) 178 ALR 304, [46].

[264] Bill Dixon, 'Can the Common Law Obligation of Good Faith be Contractually Excluded?' (2007) 35 *ABLR* 110.

[265] S K O'Byrne, 'Good Faith in Contractual Performance: Recent Developments' (1995) 74 *Canadian Bar Review* 70, 96.

[266] Ibid.

[267] W Grover, 'A Solicitor Looks at Good Faith in Commercial Transactions' in *Commercial Law: Recent Developments and Emerging Trends* (*Special Lectures of the Law Society of Upper Canada, 1985*) (1985) 106-107 as referred to by O'Byrne, above n 265, 96.

disclaims absolutely any obligation of good faith or allows one party to the contract to be dishonest or wantonly destructive of the fruits of the contract is unlikely to be validated.[268] Depending on the circumstances, an 'opting out' clause of this nature may also be indicative of unconscionability[269] or may possibly operate to render the contract illusory.[270]

Of course, if a commercial document clearly and unambiguously disavows any implied obligation of good faith in contractual performance and enforcement, it will then be a matter for a party's commercial judgment if the party is prepared to sign the document in that form. In this way, the commercial reality is that the debate may be transformed from a potential post-contractual good faith debate to a debate centred on contract formation issues. These issues are beyond the scope of this paper. Suffice to say, a party who signs such a document in circumstances where the party was offered no realistic choice or denied the opportunity to negotiate, may not be left without a remedy, albeit not necessarily a common law remedy.

Finally, consistent with observations that I have made elsewhere,[271] if it is intended to exclude the implied good faith obligation, it should not be assumed that a 'sole discretion' clause or an 'entire agreement' clause will, in isolation, be sufficient.

4. Conclusion

This brief examination of Australian good faith litigation demonstrates both judicial inconsistency and caution at lower court levels. Examples of successful reliance on the implied obligation of good faith in contractual performance and enforcement remain relatively few.[272] Perhaps this is not surprising, being arguably a reflection of the content of the good faith obligation being consonant with, and shaped by, the reasonable expectations of both contractual parties. An underlying basis of reasonable expectations does not preclude the pursuit of legitimate self-interest. Decisions that some may consider harsh in their result,[273] merely serve as a striking illustration of this point. To successfully pursue a claim for breach of the implied obligation of good faith compelling proof will be required that a contractual party has acted in a manner clearly beyond the reasonable expectations engendered by the relevant commercial context. This will usually require direct proof of substance rather than arguments based on inference or the like.[274]

[268] O'Byrne, above n 265, 96.

[269] Ibid.

[270] A possibility referred to by Paterson, above n 95, 280.

[271] Dixon, above n 264, 120 - 121.

[272] An observation made elsewhere: Wallwork, above n 1, 267.

[273] See, eg, *Advance Fitness v Bondi Diggers* [1999] NSWSC 264.

[274] Evidential difficulties were suffered by the plaintiff in *Hoppers Crossing Club Ltd v Tattersalls Gaming Pty Ltd* [2005] VSC 114, [27].

As I have noted before,[275] if the High Court were to accept that the basis of the implied good faith obligation is the reasonable (or legitimate) expectations of the contracting parties, then the introduction of good faith into contract law should not be seen as 'judicial moralism'[276] but merely the adoption of a doctrinal approach that has been well recognised in recent times.[277] Commercial contract law would still be fundamentally about achieving one's own ends, but those ends would be 'understood largely in terms of the context out of which they arise'[278] and the reasonable expectations engendered by that commercial context.

However, until such time as the High Court meets this challenge, commercial advisers will continue to best serve their client's interests by clear and explicit contractual drafting.

[275] Bill Dixon, 'What is the Content of the Common Law Obligation of Good Faith in Commercial Franchises?' (2005) 33 *ABLR* 207; Bill Dixon, 'What is the Content of the Common Law Obligation of Good Faith in Commercial Leases?' (2007) 14 *APLJ* 113.

[276] O'Byrne, above n 265, 76 citing the language used by Kelly J in *Gateway Realty Ltd v Arton Holdings Ltd* (1991) 106 NSR (2d) 180, 197.

[277] In the context of contract law generally (rather than good faith analysis alone) the protection afforded to the reasonable expectations of the contractual parties is a benchmark that enjoys a considerable pedigree of judicial and academic support. Eisenberg, amongst other academic writers, has noted that contract law is to a significant extent about the protection of reasonable expectations: M Eisenberg, 'The Theory of Contracts' in Peter Benson (ed), *The Theory of Contract Law: New Essays* (2001) 246. In a similar manner, Finn J and Smith have observed that that the protection of reasonable (or legitimate) expectations is now 'part of the common rhetoric of Australian law': P Finn and K J Smith, 'The Citizen, the Government and 'Reasonable Expectations'' (1992) 66 *ALJ* 139, 140. Perhaps this benchmark is best encapsulated in the observation of Sir Robin Cooke that 'giving effect to reasonable expectations … is a prime object of the law in almost all fields': Sir Robin Cooke, 'Book Review' (1992) 108 *LQR* 334, 336 as referred to by Mason, above n 7, 72.

[278] To adapt the words of J M Feinman, 'Relational Contract Theory in Context' (2000) 94 *Northwestern University Law Review* 737, 743.