



Is there a duty to act in good faith in joint venture agreements?

03 July 2006

The short answer is yes, there is a duty to act in good faith in joint venture agreements. However, because this duty is not codified in Australia, determining when and how it applies is a more complex issue. The recent Victorian case of *Esso Australia Resources Pty Limited v Southern Pacific Petroleum* adds to the current debate on the duty of good faith in Australian contract law.

Southern Pacific Petroleum (SPP) became insolvent and sought to assign its interests in a joint venture agreement (JVA) to a specially created company. The JVA permitted the assignment of interests to SPP's subsidiary companies without Esso's consent. Esso claimed that the special purpose company was established by SPP in bad faith, solely to circumvent the requirement to obtain Esso's approval.

The Supreme Court upheld the assignment, stating that SPP did not show a lack of good faith or fair dealing by promoting its own interests or by taking advantage of the JVA clause which permitted SPP to assign its interests to the specially created company without Esso's consent. When the parties entered into the contract, both accepted that there was a commercial risk of SPP becoming insolvent. Esso's appeal to the Court of Appeal was dismissed.

Implications for commercial contracts

The Court's ruling in *Esso* implies that a party's ability to assign its interests in accordance with the terms of a contract, commercially agreed between the parties, will not constitute a lack of good faith if there is reference to both parties' legitimate interests.

The duty of good faith is not implied in all commercial contracts, nor should it be incorrectly or indiscriminately applied to all rights and powers in a commercial contract.

Given the varying case law it is not possible to know for certain if and when such a duty will be implied by the courts. The uncertainty adds to project risk and project costs.

The duty of good faith is more likely to be implied into a relationship contract, such as a JVA, partnering or alliancing contract rather than a traditional construction contract given their collaborative nature.

The definition of 'duty of good faith' is becoming ripe for High Court review given the piecemeal approach taken by the various courts across the country. A definable duty, which can be readily implied by the courts into identifiable situations needs to be developed. Until then, uncertainty will continue.

Duty of good faith – underlying principles

- good faith can be compared with reasonableness
- parties must not act capriciously
- a party must not prevent the performance of a contract or withhold any of its benefits
- parties cannot try to further purposes which are outside of rights conferred in the contract
- parties cannot rely on the 'black letter' or (literal interpretation) of the contract if it is inconsistent with the implied obligation of good faith. The duty of good faith supports the spirit and the integrity of the contract
- it will not be a lack of good faith or fair dealing to promote your own interests, as long as it is consistent with the terms of the contract
- the duty to act in good faith does not include a duty to prefer the interests of one party over another's, but there is a duty to have due regard to both parties' legitimate interests as provided for in the contract.

For further information about this article please contact David McElhone on +61 2 9921 4718.

[top](#)

© Minter Ellison 2009

[About Us](#) | [People](#) | [Expertise](#) | [Legal Insights](#) | [Careers](#) | [Community](#) | [International](#) | [eLibrary](#) | [oag](#) |
[Contact Us](#) | [Sitemap](#) | [Terms of Use](#) | [Privacy](#) |