Journals

A requirement of good faith in construction contracts?

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[This article is 13 pages in BCL]

(2004) 20 BCL 257

Professors Carter and Stewart in their Journal of Contract Law article "Interpretation, Good Faith and the "True Meaning" of Contracts – The Royal Botanic Decision" ,[1] contend that recognition of an implied requirement of good faith in the performance and enforcement of contracts is, perhaps, the most important unresolved issue in Australian contract law. In that article, the authors were particularly critical of the New South Wales Court of Appeal's decisions equating a requirement of good faith with an implied term of reasonableness. They argued that the imposition of an overriding objective standard of reasonableness into contracts risked altering bargains and had potential to subsume a number of other established legal principles.

An implied requirement of good faith?

Carlin in his article "The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia" [2] is highly critical of the process of development of the doctrine of good faith in contractual performance in Australia, contending that the doctrine perhaps should be based on different foundations.

Peden in her book Good Faith in the Performance of Contracts [3] is also critical of the approach of the New South Wales Court of Appeal, particularly because of its failure to distinguish between good faith and objective reasonableness and its finding that a requirement of good faith is a term implied by law into contracts generally. This second aspect marks a departure from the previous approach to implication of terms by law into particular classes of contract based on necessity or common understanding in particular relationships.

Recent decisions suggest that this criticism is having an impact. This article examines the status, content and extent of an implied term of good faith. Then it considers possible approaches of the High Court to this issue. In conclusion, it examines the implications for parties negotiating and drafting construction contracts.

The implied requirement of co-operation

In an area of law containing a number of uncertainties it is reassuring that there are some established principles. One of these is the existence of an implied requirement to co-operate. As Lord Blackburn stated in Mackay v Dick *[1881] 6 App Cas 251*:

[A]s a general rule … where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part of the carrying out of that thing, though there may be no express words to that effect.[4]

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This principle has been endorsed in recent High Court decisions including Peters (WA) Ltd v Petersville Ltd (2001) *205 CLR 126* [PDF].
One example where this requirement would apply would be where a contractor cannot proceed to obtain an approval for a project as it is contractually obliged to do without the signature of the principal on the application.

Is there also a requirement of good faith implied into commercial contracts?

The High Court has not yet pronounced on this issue. In Royal Botanic Gardens and Domain Trust v South Sydney CC (2002) *186 ALR 289*, the High Court was asked to interpret the lessor's power to fix rent for the lease of the land accommodating the Sydney Domain Parking Station. In this context, the issue was raised and acknowledged but ultimately bypassed. Five judges including Gleeson CJ observed that there is "a debate in various Australian authorities concerning the existence and content of an implied obligation or duty of good faith and fair dealing in contractual performance and the exercise of contractual rights and powers." [5] However, as both parties accepted the existence of such an obligation in the exercise of the relevant rental determination power the five judges considered that "this is an inappropriate occasion to consider [the existence and scope of a 'good faith' doctrine]." [6]
There has been strong judicial support for the requirement in New South Wales. In Burger King Corporation v Hungry Jack's Pty Ltd *[2001] NSWCA 187*, the New South Wales Court of Appeal comprising Sheller, Beazley and Stein JJA stated:
A review of cases since Alcatel indicates that courts in various Australian jurisdictions have, for the most part, proceeded upon an assumption that there may be implied, as a legal incident of a commercial contract, terms of good faith and reasonableness.[7]
In Burger King , the dispute arose out of the purported termination by Burger King of its development agreement with Hungry Jack's. The development agreement entitled and required Hungry Jack's to open additional restaurants each year. However, one clause of the development agreement made it a condition of Burger King's approval for new restaurant franchises, "that Hungry Jack's must have, in the sole discretion of [Burger King], operational, financial and legal approval at the time of application for a franchise." [8] Operational approval requirements included Hungry Jack's being obliged to ensure that, among other subjective elements, restaurants reflected "an acceptable Burger King image" [9] and that the restaurants complied with Burger King's manual of operating data, which "contains the most detailed requirements relating to every aspect of operating a Burger King restaurant from food handling to recruiting, cleaning and manner and style of service" [10] (including a nine-phase service procedure complete with smiles, greetings and parting phrases). Burger King was also entitled to change the applicable standards, specifications and procedures at its sole discretion.
The court accepted that it was necessary to imply a requirement of reasonableness and good faith into the restaurant development agreement between Burger King and Hungry Jack's so as to avoid Burger King, "for the slightest of breaches, bringing to an end the very valuable rights which [Hungry Jack's] had under the Development Agreement." [11]
In Overlook Management BV v Foxtel Management Pty Ltd *[2002] NSWSC 17*, a case concerning arrangements between Foxtel and one of its television content providers, Barrett J stated that:

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An additional term implied by law into commercial contracts is a term requiring the exercise of good faith in the performance of the contract. This is now in this State a legal incident of every such contract: Burger King Corporation v Hungry Jack's Pty Ltd *[2001] NSWCA 187*.[12]
In Commonwealth Bank of Australia v Spira *[2002] NSWSC 905*, Gzell J followed Overlook and found that a term of good faith was implied into a loan facility agreement as a matter of law. In Hunter Business Finance v Australian Business and Equipment Finance *[2003] NSWSC 122*, Gzell J followed his previous decision and found that the term was also implied into the terms of engagement of several finance brokers. In that case, he also found that the finance brokers had breached their obligation of good faith when they took and copied files from Hunter Business Finance and utilised them in their new business.[13] In Biscayne Partners Pty Ltd v Vallance Corp Pty Ltd *[2003] NSWSC 874*, Einstein J also found that it was an implied term of Holly Vallance's management agreement that she and her management company would act in good faith in the exercise and performance of their respective rights, powers and obligations in and under the management agreement.
However, in the recent New South Wales Court of Appeal decision Vodafone Pacific Ltd v Mobile Innovations Ltd *[2004] NSWCA 15*, Giles JA (with whom Sheller and Ipp JJA agreed) concluded that the law has not gone so far as to say that commercial contracts are a class of contracts carrying the implied term as a legal incident. Indeed, Giles JA stated that "the width and indeterminacy of the class of contracts would make it a

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large step." [14] He further stated that the Burger King test for contracts outside the traditional classes is whether the term itself is reasonable and necessary.[15]

In Victoria in Far Horizons Pty Ltd v McDonald's Australia Ltd *[2000] VSC 310*, a McDonald's franchising case, on this occasion, Byrne J of the Victorian Supreme Court, stated that: "As I indicated to counsel in argument, I do not see myself as at liberty to depart from the considerable body of authority in this country which has followed the decision of the New South Wales Court of Appeal in Renard Construction (ME) Pty Ltd v Minister for Public Works . I proceed, therefore, on the basis that there is to be implied in a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose. Such a term is a legal incident of such a contract." [16]

However, subsequently, Hansen J, in Playcorp Pty Ltd v Taiyo Kogyo Ltd *[2003] VSC 108*, found that a requirement of good faith was not implied by law into a distribution agreement for the supply of toys. He said:

The term [sought to be implied] is of such width and uncertainty as, in the circumstances, to belie its implication as a matter of law. The present is a commercial contract between two independent parties providing for the international sale of goods. Each party is a substantial organisation well able to attend to its own interests. It is not a contract under which, relevantly, one party is to consider whether, and how, to exercise a power that will affect the ability of the other party to have the benefit of the contract, as, for instance, in Renard Constructions (ME) Pty Ltd v Minister for Public Works . And it is not a contract in which, relevantly to the present issue, there is a need to imply a term of good faith.[17]

The existence of an implied requirement of good faith has also been considered in federal courts. In Hughes Aircraft Systems International v Airservices Australia (1997) *76 FCR 151* [PDF], Hughes Aircraft alleged that the predecessor to Airservices Australia, which was a statutory body, had failed to satisfy its obligation to conduct a tender for an air traffic control system fairly. Finn J observed what he believed to be a community expectation as to a standard of fairness in contract, noting that fair dealing is a major organising idea in Australian law. Finn J went on to hold that a duty of fair

dealing was implied in fact (ad hoc) into the tender process contract, and could also have been implied as a legal incident to the particular class of contract concerned.

In Garry Rogers Motors (Australia) Pty Ltd v Subaru (Australia) Pty Ltd *[1999] FCA 903*, Finkelstein J observed:

The first of the two substantive arguments that the applicant has put forward in support of an interlocutory injunction is based on the alleged implied term of good faith and fair dealing. The first respondent was prepared to accept the implication of such a term in the dealership agreement for the purposes of the interlocutory application. It could hardly do otherwise. Recent cases make it clear that in appropriate contracts, perhaps even in all commercial contracts, such a term will ordinarily be implied; not as an ad hoc term (based upon the presumed intention of the parties) but as a legal incident of the relationship.[18]

However, this statement and the earlier decision of Finn J in Hughes Aircraft Systems may be contrasted with the earlier Federal Court decision of Gummow J in Service Station Association Ltd v Berg Bennett & Associates Pty Ltd (1993) *117 ALR 393*, where he stated:

Anglo-Australian contract law as to the implication of terms has heretofore developed differently, with greater emphasis upon specifics, rather than the identification of a genus expressed in wide terms. Equity has intervened in matters of contractual formation by the remedy of rescission, upon the grounds mentioned earlier. It has restrained freedom of contract by inventing and protecting the equity of redemption, and by relieving against forfeitures and penalties. To some extent equity has regulated the quality of contractual performance by the various defences available to suits for specific performance and for injunctive relief. In some, but not all, of this, notions of good conscience play a part. But it requires a leap of faith to translate these well established doctrines and remedies into a new term as to the quality of contractual performance, implied by law.[19]

The approach of Gummow J (now, of course, a High Court judge) in Service Station Association has recently been followed in the Federal Court by Heerey, Whitlam and Weinberg JJ in Wenzel and Rough v Australian Stock Exchange Ltd *[2002] FCAFC 400*, where the court held that a term of fair dealing was not implied into admission agreements for the ASX, and expressed support for the view that there is no such generally applicable implied term under Australian law. The joint judgment in that case cited both the Carlin and the Carter and Stewart articles, mentioned above, with approval.[20]

In GEC Marconi Systems Pty Ltd t/as EASAMS Australia v BHP Information Technology Pty Ltd *[2003] FCA 50*, Finn J acknowledged that "[there] is not yet agreement in this country as to the province of good faith in contract law." [21]

In light of differences in the opinions expressed and the terms used to describe the content and extent of the requirement (see below), High Court authority in this area is anticipated. However, until then, it seems prudent to proceed on the assumption that a term requiring the exercise of good faith in the performance of the contract may be implied by law into construction contracts. In drafting and exercising contractual rights

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and powers and in making related business decisions, contracting parties will need to bear in mind the fetters which appear to form part of the content of the implied duty of good faith (as described in the following section of this article).

What does good faith mean in practice?

Despite the frequent pronouncements as to the existence of an implied duty of good faith, in the author's view, the cases have not clearly defined the content of the duty beyond the terms of the existing (Mackay v Dick) implied requirement to co-operate. In Burger King , Sheller, Beazley and Stein JJA referred to the statement of Sir Anthony Mason in his 1993 Cambridge lecture that it was probable that the concept of good faith "embraced no less than three related notions," being:

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1 an obligation on the parties to cooperate in achieving the contractual objects (loyalty to the promise itself);

2 compliance with honest standards of conduct; and

3 compliance with standards of conduct which are reasonable having regard to the interests of the parties.[22]

As Barrett J observed in Overlook , "there is some overlap here with the terms implied by law as referred to in Peters (WA) Ltd . Sir Anthony's duty of 'loyalty to the promise itself' may well include the duties not to hinder fulfilment of the promise's purpose and to do everything necessary to enable the other party to have the benefit of the promise. The more substantial and separate content of the duty of good faith itself would therefore seem to lie in the second and third limbs of Sir Anthony's formulation – that is, adherence to standards of conduct which are honest, as well as being reasonable having regard to the parties' interests." [23]

In Overlook , Barrett J continued with his review of Burger King and other relevant authorities: "If adherence to such standards of conduct is the predominant component of a separate obligation of good faith in performance of a contract, it becomes necessary to enquire about the extent to which selflessness is required. It must be accepted that the party the subject to the obligation is not required to subordinate the party's own interests, so long as pursuit of those interests does not entail unreasonable interference with the enjoyment of a benefit conferred by the express contractual terms so that the enjoyment becomes (or could become), in words used by McHugh and Gummow JJ and Byrne v Australian Airlines Ltd (1985) *185 CLR 410* [PDF], 'nugatory, worthless or, perhaps, seriously undermined'." This seems to me to be the principle emerging from the joint judgment in Burger King *(at [172]-[177])*, where the various authorities are collected and discussed.

Viewed in this way, the implied obligation of good faith underwrites the spirit of the contract and supports the integrity of its character. A party is precluded from cynical resort to the black letter. But no party is fixed with the duty to subordinate self interest entirely, which is the lot of the fiduciary: Burger King *at [187]*. The duty is not a duty to prefer the interests of the other contracting party. It is, rather, a duty to recognise and have regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.

In many ways, the implied obligation of good faith is better regarded as an obligation to eschew bad faith.[24]

In summary, Barrett J appears to consider that the implied duty of good faith includes:

(a) the implied duty to co-operate (Mackay v Dick);

(b) a duty to act honestly (which also appears to have been accepted by Einstein J as an element of an express duty to negotiate in good faith in Aiton Australia Pty Ltd v Transfield Pty Ltd (2000) *16 BCL 70*);

(c) a duty to recognise and have regard to the legitimate interests of the other party in enjoying the bargained for benefits (but that this duty is not a fiduciary one); and

(d) an obligation not to act in bad faith (this approach to defining good faith is frequently termed "excluder analysis").[25]

In Overlook , Barrett J found that Foxtel had not breached the implied term. The facts were as follows. Overlook and Foxtel had entered into a series of contracts whereby Overlook would provide Foxtel with non-English language channels for Foxtel to distribute with its pay television programming. Under the agreements, Foxtel was to pay a fixed percentage of the fee charged by Foxtel to its subscribers for the channels. Overlook also had similar arrangements with Optus. Both

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Foxtel and Optus marketed their services on the basis of a fixed monthly subscriber fee with certain minimum channels and a further add-on fee for the non-English speaking channels. Foxtel's initial monthly charge was $44.95 and the further add-on fee was $19.95. Optus' basic package was $19.95 and its add-on fee for the non-English language services was also $19.95. The litigation arose because Foxtel lowered its add-on fee for the non-English speaking channels to $9.95. This significantly reduced the return to Overlook from Foxtel and also risked its returns from Optus, as it was open for subscribers to "churn" from Optus to Foxtel where the combined package was now more competitively priced. It should be noted that this was not a case where Foxtel was exercising a power or discretion under its agreements with Overlook in a manner which prejudiced Overlook.

Barrett J found that Foxtel had not breached the implied term of good faith, because in making its commercial decision regarding the price to be charged for its add-on package, it had acted in good faith in the belief that a short-term revenue loss would be outweighed by increased market penetration in the long run. He also found that the implied term could not preclude Foxtel from trying to encourage subscribers to move from Optus to Foxtel even if this also caused Overlook loss. This was a fundamental part of Foxtel's business strategy of which Overlook was aware.

Similarly, Byrne J, in Far Horizons , found that McDonald's decision to open restaurants which were expected to take sales from an existing licensee was not a breach of an implied duty of good faith. The licensee knew that it had no area of market exclusivity and "the agreement was entered into in an environment when each party was well aware that the opening of new stores was an ordinary part of the McDonald's way of doing business and that this will in many cases involve an impact upon the business of an existing licensee." [26]

In contrast, Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd (2000) *16 BCL 255* is a case where a breach of good faith was found in the context of an express requirement of good faith in the partnering contract for mining operations at the Granny Smith goldmine. The partnering contract was based on a risk-sharing principle (that is, that the risk of cost fluctuations be shared between Thiess and Placer) and provided for a fixed profit to be earned by Thiess, being an agreed percentage on costs. In that case, the Full Court of the Supreme Court of Western Australia held that Thiess had breached an obligation of good faith by knowingly misrepresenting that certain rates were its genuine estimate of actual costs when they actually included profits.

Other cases have stated a fifth principle, that the obligation of good faith includes a requirement that a party must not act arbitrarily, capriciously or for an extraneous purpose.[27] Has the party made a legitimate business judgment?

In Burger King , the court stated that, "[Burger King's] contractual powers [under the relevant clause of the development agreement] are to be exercised in good faith and reasonably. That does not mean that [Burger King] is not entitled to have regard only to its 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 [Hungry Jack's] rights under the contract." [28] The discretion "was one which was required to be exercised reasonably so that it could not be used for a purpose foreign to that for which it was granted, such as to thwart [Hungry Jack's] right to develop and ultimately to procure a situation where the [development agreement] could be terminated." [29]

The court held that Burger King had breached the implied terms of co-operation, good faith and reasonableness by placing a freeze on the ability of Hungry Jack's to recruit third party franchisees and withholding operational and financial approvals to development under the development agreement. These actions could also be construed as either an abuse of Burger King's power to

determine compliance with the development agreement or an attempt to re-capture an opportunity to enter the Australian fast food market, which Burger King had granted to Hungry Jack's when it franchised its operations in Australia to Hungry Jack's.[30]

The Burger King decision may be contrasted with Garry Rogers Motors where the supplier required the dealer to comply with a new marketing program and the dealer refused to do so. Termination in such circumstances in accordance with an express term in the contract was not a breach of an implied term of good faith even though the dealer subsequently offered to comply with the program. Subaru had not acted capriciously or for an extraneous purpose. Similarly, in Apple Communications Ltd v Optus Mobile Pty Ltd *[2001] NSWSC 635*, Optus' exercise of its express unilateral right of termination following 30 days' written notice "per any reason" was not held to be in breach of an implied term of good faith when it was exercised in order that Optus could "rationalise and regain control of its distribution arrangements." [31] It was not exercised capriciously or for an extraneous purpose merely because "the termination reason had nothing to do with the conduct of Apple or its performance as distributor." [32]

In addition, the termination could not be impugned even though Optus had held the view that it wished to rationalise its distribution arrangements prior to entering into its arrangements with Apple. Windeyer J stated that, "Businesses as large as Optus must constantly be considering changes to their modes of operation and certainly could not be expected to disclose these considerations in a way which might make them public … As there was clearly considerable work to be done before any final new distribution system was decided upon, it does not seem to me that it was unreasonable to enter into the distribution agreement with Apple taking into account the fact of its being a commercial

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agreement in a competitive industry." [33] It is implicit that Apple knowingly took the business risk that Optus could exercise the power to terminate for convenience.

How is the High Court likely to approach this issue?

For supporters of the implication of a broad term requiring contracting parties to exercise good faith and reasonableness in all their contractual dealings, the indications from the current High Court have not been encouraging. Although five judges in Royal Botanic Gardens did not consider it an appropriate occasion on which to rule on the existence and extent of an implied duty of good faith, the other two judges did make observations concerning the issue. Kirby J said:

Much time was taken in exploring the common law cases by which, in leases between private parties affording machinery for the determination of a "price" but no explicit formula, obligations to act fairly and reasonably will be implied into the contract so as to save it from failure and to provide a measure by reference to which the "price" can be objectively proved. The Court was taken to case law both in this country and overseas as well as to academic commentary to demonstrate a growing tendency to imply into private contractual dealings a covenant of good faith and fair dealing. As expressed in some United States decisions, this is a principle that is not confined to an obligation to exercise express contractual powers fairly and reasonably. In some parts of the United States, the obligation has been accepted as a general implied contractual term in its own right.

However, in Australia, such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include.[34]

Callinan J also stated in the same case:

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In view of the conclusion I have reached, it is unnecessary to answer the questions raised by the rather far-reaching contentions of the appellant, and for which, it says, Alcatel Australia Ltd v Scarcella and Burger King Corp v Hungry Jack's Pty Ltd stand as authorities: whether both in performing obligations and exercising rights under a contract, all parties owe to one another a duty of good faith; and, the extent to which, if such were to be the law, a duty of good faith might deny a party an opportunistic or commercial exercise of an otherwise lawful commercial right.[35]

Is the implied term necessary or justified?

A key hurdle for the High Court to overcome in determining that a duty of good faith is implied by law into all commercial contracts (including construction contracts) is satisfying the requirement for implication of a term by law that the term be necessary or part of common understanding. The decisions in Vodafone Pacific , Playcorp and Wenzel and Rough (mentioned above) appear to be indicating a trend back to reasserting this requirement. Is it a necessity for each contracting party to have a right of action to sue for breach of contract because its co-contracting party does not act reasonably or in good faith? Is the introduction of this cause of action appropriate in the context of sophisticated contracting parties which have voluntarily assumed obligations and have not sought to protect themselves by the express inclusion of such a term? Can the term be implied on the basis of common understanding when it is sometimes expressly included and frequently (at least in the case of a requirement of reasonableness) expressly excluded? There may be a strong case for the view that the implication of a term of good faith and reasonableness into all commercial contract arrangements between sophisticated contracting parties may not be necessary.[36] The existence of such an implied term may inject an element of uncertainty into these arrangements.

The existence of a number of established rules and principles which may apply to protect the interests of weaker parties in commercial arrangements also supports the argument that it is not necessary to imply a requirement of good faith into all commercial contracts. Some rules and principles which may be relevant in similar circumstances are promissory estoppel, unjust enrichment, unconscionable conduct, undue influence and economic duress. An independent cause of action for breach of contract where a contracting party does not act in good faith or reasonably may overlap with several of these existing rules and principles and unconscionable conduct in particular. Carter and Stewart stressed this point.[37] Carter and Peden have suggested that good faith should be recognised as an underlying principle supporting many established rules and principles of contract law and other related doctrines (including the principles to apply in interpreting contacts), rather than as an independent contractual obligation imposed over the top of them.[38]

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There are also significant statutory provisions which govern commercial conduct. For example, several of the authorities described above concern franchising arrangements, and the Trade Practices Act 1974 (Cth), s 51AC , specifically addresses unconscionable conduct in the context of such arrangements.

Is implication of the duty built on secure foundations?

As observed above, the Full Federal Court in Wenzel and Rough found Carlin's argument as to structural deficiencies persuasive. Carlin focused particularly on the precedent value of Renard Constructions (ME) Pty Ltd v Minister for Public Works (1992) *26 NSWLR 234* [PDF] and Hughes Aircraft for the implication of a requirement of good faith. These cases have frequently been referred to as the basis of the doctrine in Australia (see for example, Byrne J in Far Horizons).

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Renard concerned the principal's exercise of a termination right following a "show cause" procedure under a standard form construction contract. The majority in Renard found that in that case the principal was required to exercise the power reasonably. It did not find that there was an implied duty of good faith in contractual performance. As Carlin points out, only Priestley JA addressed the issue of good faith in that case, and he specifically noted that it did not form part of his reasons for judgment.[39]
Carlin also is critical of Priestley JA's advocacy of good faith in contractual performance on the basis of his appeal to "community expectations" and "a growing judicial trend towards the recognition and application of good faith and fairness principles into contractual settings," as well as his approval of the role of the doctrine in United States jurisprudence. He questions whether the term would have satisfied the requirements for implication by law in contracts. Was it a necessity or so much a part of common understanding or practice that the courts should import it as a matter of course?[40]
Carlin's criticism of the precedent value of Hughes Aircraft is primarily because Finn J's decision is based on implication of a term requiring good faith in light of the particular facts of the case, rather than implication of the term by law. Carlin is also critical of Finn J's conclusion that implication at law would also have been appropriate because the support given for this finding was Finn J's preference for an approach taken to this issue in United States jurisprudence and the specific circumstances of the applicable public authority tender process.[41]

Will the high court require good faith?

Abandon general implication of a term of good faith into all commercial contracts

The author's strong preference is for the High Court to reject the general implication of a term of good faith into all commercial contracts. The potential existence of this implied term is creating uncertainty for parties when they wish to exercise express contractual rights and powers and is prolonging negotiations as parties seek to reinforce apparently clear contractual rights. If the High Court does adopt this course, this author expects that the High Court will reassert the requirement of co-operation laid down by Mackay v Dick and find that the decision in Burger King is justified on the basis of the established requirement "that a party must act honestly and do 'all such things as are necessary … to enable the other party to have the benefit of the contract'." [42]

Or endorse the implication of a term of good faith into all contracts

If the High Court does endorse the principle of a duty of good faith implied by law into all commercial contracts, it is to be hoped that further guidance as to the content of the implied duty is provided. Does the required standard of good faith include all five principles identified earlier in this article or are some of the principles simply examples of a broader principle? To what extent must regard be paid to another contracting party's interest?
One area where clarification is definitely required is the question whether the implied term of good faith obliges contracting parties to act reasonably (in an objective sense) or indeed, whether there is a separate implied term to this effect.
In Renard , Priestley JA, in considering an implied obligation of good faith in the contract, stated:
There is a close association of ideas between the terms unreasonableness, lack of good faith and unconscionability. Although they may not always be co-extensive in their connotations, partly as a

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result of varying senses in which each expression is used in different contexts, there can be no doubt that in many of their uses there is a great deal of overlap in their content.[43]

However, in the following cases, a distinction has not always been maintained. This was acknowledged in Burger King , where the court said:

It is worth noting that the Australian cases make no distinction of substance between the implied terms of reasonableness and that of good faith.[44]

The importance of maintaining a distinction between good faith and reasonableness was also highlighted by Einstein J in Aiton , where he cited the following statement of Stapleton LJ with approval:

The inter-relationship of and difference between good faith and reasonableness is subtle but of great importance. A requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith.[45]

However, subsequently in his judgment in Biscayne Partners Pty Ltd v Vallance Corporation Pty Ltd *(at [135] and [136])*, he referred with apparent concurrence to the New South Wales Court of Appeal's focus in Burger King upon the implied term of reasonableness and the lack of any distinction of substance between that term and the implied term of good faith.

Concern with respect to the use of terminology and adequacy of the definition of the content of the implied term of good faith was also expressed by Gzell J in Commonwealth Bank of Australia v Spira , where he stated that although he was prepared to adopt Barrett J's delineation of the content of the duty of good faith, for the purpose of the particular case, he wished to mention that:

[T]he content of the implied term of good faith may need further scrutiny to avoid being merely a slogan.[46]

He went on to state that:

The obligation of good faith requires a party to exercise rights and obligations under the contract fairly and, it would seem, reasonably.[47]

Rule of interpretation not an independent duty

The High Court may find that a requirement of good faith exists in exercising powers and discretions under contracts but limit the principle to a rule of interpretation applying in respect of express rights and powers rather than an independent implied term. Peden, in particular, has expressed the view that the implied duty of co-operation is a principle of interpretation and not an independent term in all contracts.[48]

In such circumstances, contracting parties would be able to claim that express contractual powers and rights are construed as if they were fettered by a requirement that they may only be exercised in good faith but would not be able to claim that there exists an independent requirement of good faith which has been breached entitling them to sue for damages. It appears that this approach to the implication of the term may find favour in Western Australia where the authorities of Central Exchange Ltd v Anaconda Nickel Ltd *[2002] WASCA 94* and Automasters Australia Pty Ltd v Bruness Pty Ltd and Coombes *[2002] WASC 286*, held that if a term of good faith is to be implied in a contract it must be construed to aid and be consistent with the explicit terms of the agreement. As Peden has argued, "[t]his approach would have several advantages [over implication of a term into contracts]. There would be no uncertainty as to whether a term is implied or not and no

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confusion about which test should be applied. Furthermore, an obligation of good faith could still be avoided by commercial parties that made their contracts sufficiently clear, since construction is dependent on the nature of and factual matrix of the contract in question." [49]

Implied term in classes of contract

Although the High Court may determine that there is no general implication of such a term into contracts, it may approve of the implication of the term into particular classes of contracts. In the authorities previously mentioned, views have been expressed that a requirement of good faith may be more easily implied into standard form contracts, "relational contracts" (such as franchising arrangements and joint venture agreements) or pre-contract tender contracts with public bodies. Certain construction arrangements such as alliancing arrangements and indeed, long-term construction contracts and PPP arrangements are likely to be classified as relational contracts in such circumstances.

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Conclusion: what can be done contractually?

The current state of the law requires all contracting parties to proceed with caution. In exercising contractual powers and discretions (and perhaps also when carrying out their business more generally, as Overlook suggests), parties must:

(a) act honestly and co-operatively;

(b) consider the interests of other parties to bargains; and

(c) make legitimate business decisions.

However, the cases highlight that breaches of the implied requirement of good faith are hard to find in the context of Australian commercial contracts. If parties draft rights and powers in terms appropriate to the nature of their contractual relationship, it seems unlikely that they will be found to have breached an implied term of good faith in exercising them in accordance with their terms unless they do so clearly in bad faith. For examples, see Far Horizons , Apple Communications and Burger King .

Indeed if parties draft their terms clearly it seems that they may exclude an implied term of good faith.[50] As Giles JA acknowledged in Vodafone Pacific , there may be excellent reasons for structuring contracts in this way. In that case there was a fundamental tension between the parties' interests, since the more subscribers Mobile Innovations acquired the more it was paid, yet from Vodafone's perspective, the optimum level of new subscribers depended on whether the subscribers were profitable to Vodafone: "[The agreement] could only work if, should it be necessary, one party or the other had the whip hand." [51]

Parties should always carefully consider the fetters which they are prepared to accept on the exercise of specific rights and powers. Where the parties agree that certain rights and powers are only to be exercised in circumstances where a party is acting reasonably or in good faith, it is better to state this explicitly as the existence and content of the implied requirement remains uncertain. For this reason, it is also worth explicitly stating that where a reasonable standard is required in the exercise of particular contractual rights, what is reasonable in the circumstances is to be determined having regard to the terms of the arrangements between the parties. What is reasonable in project financed construction documentation is likely to be different from what is reasonable in the context of a contract for a single residential dwelling. Parties may also wish to go further still in the interests of certainty and define what they are required to do in particular circumstances in order to satisfy a "reasonableness standard" for a particular power.

(2004) 20 BCL 257 at 268

The judgment of Conti J in Telstra Corporation Ltd v Optus Networks Pty Ltd *[2002] FCAFC 296* supports the view that it is worth carefully defining the obligations that one wishes to take on. In that case, the court considered that the ambit of an express obligation of good faith did not extend the content of the express terms dealing with the relevant circumstances. Conti J stated that, "it is difficult to conceive, how Optus can achieve an outcome, by the side wind of the Good Faith Obligation, in relation to the extent of operation of any one or more of the Preselection Availability, Access Service and Barring Obligations, beyond [the scope of any one or more of the specific obligations created by the Access Agreement]." [52]

Much of the concern about the state of the law arises from the tension between the existence of a general requirement to act reasonably and a party's wish to specifically identify powers that it wants to be able to exercise for its own legitimate business purposes (without consideration of the other party's interests). Examples of principal's powers and functions which should be considered in this light include powers of suspension and termination, the superintendent's unilateral right to extend time and approval rights concerning security providers, insurers and subcontractors. However, it is important to remember that despite certain courts' enthusiasm for the implied term, judges have been at pains to stress that it cannot override express terms. Barrett J stressed this in LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd (2002) *18 BCL 57*, where he stated that "[it] is important to recall, however that the implied terms mentioned are, of their nature, incapable of rising above express terms." This was also acknowledged by Finn J in GEC Marconi Systems ,[53] where he stated that "as a matter of legal doctrine in this country it must be accepted that, as an implied term [the duty of good faith and fair dealing] is capable of being excluded by express or by inconsistent provision – although it is, perhaps, difficult to envisage an express provision authorising dishonesty."

As can be seen from Vodafone Pacific , the requirement may be excluded and Giles JA found:

[The] power in cl 18.4 [to determine the target level of new subscribers to be acquired by Mobile Innovations] was emphatically described as a sole discretion … [T]he point of "sole" lay in the exclusion of any constraint upon Vodafone. Its exercise was excluded from the dispute resolution procedure, with the further emphasis that "Vodafone's decision will be conclusive and binding on the parties" (cl 32.6) and the

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emphasis again that it could be exercised in any manner Vodafone saw fit (cl 41). These words in the ASP Agreement can not be passed over, and they weigh against the implied obligation of good faith and reasonableness in the exercise of the power.
The contrast is marked in this respect between the absolute discretion in cl 18.4 and other occasions when, according to the ASP Agreement, Vodafone or Mobile had to act reasonably (cll 2.9(a), 5.2, 7.7, 9.2, 10.2, 10.4(a)(i), 10.7(d), 11.1(b), 12.1(b), 13.1(a), 13.7(b), 14.4, 15.3(a)(ii), 25.11(a), 25.11(b), and 37(b)), and even in good faith (cl 11.4(g) concerning participation in mediation under the dispute resolution procedure). Without more, in my opinion, the implication of the obligation to act in good faith and reasonably in exercising the power of determining target levels in cl 18.4 was excluded. To this may be added cl 24.1(a) , by which "To the full extent permitted by Law and other than as expressly set out in this Agreement the parties exclude all implied terms." [54]
On the other hand, attempts to exclude a duty to act in good faith from any application to a contract may be less successful. In this regard, it is worth bearing in mind the statement of Sheller JA in Alcatel that:
[if] a contract confers power on a contracting party in terms wider than necessary for the protection of the legitimate interests of that party, the courts may interpret the power as not extending to the action

proposed by the party in whom the power is vested or, alternatively, conclude that the powers are being exercised in a capricious or arbitrary way or for an extraneous purpose, which is another [way] of saying the same thing.[55]
And the recent observation of Finn J in GEC Marconi Systems that:
I find arresting the suggestion that an entire agreement clause is of itself sufficient to constitute an "express exclusion" of an implied duty of good faith and fair dealing where that implication would otherwise have been made by law.[56]

Footnotes | Top

* The author gratefully acknowledges the assistance of Geoff Wood in the preparation of this article.

1 (2002) 18 JCL 182.

2 (2002) 25(1) UNSWLJ 99.

3 Peden E , Good Faith in the Performance of Contracts (Lexis Nexis Butterworths, 2003).

4 (1881) 6 App Cas 251 at 263.

5 (2002) 186 ALR 289 at 301.

6 Royal Botanic Gardens and Domain Trust v South Sydney CC *, n 5*.

7 [2001] NSWCA 187 at [159].

8 Burger King Corporation v Hungry Jack's Pty Ltd *, n 7 at [55]*.

9 Burger King Corporation v Hungry Jack's Pty Ltd *, n 7 at [183]*.

10 Burger King Corporation v Hungry Jack's Pty Ltd *, n 7 at [180]*.

11 Burger King Corporation v Hungry Jack's Pty Ltd *, n 7 at [183]*.

12 [2002] NSWSC 17 at [62].

13 [2003] NSWSC 122 at [73].

14 [2004] NSWCA 15 at [189].

15 Vodafone Pacific Ltd v Mobile Innovations Ltd *, n 14 at [189]-[191]*.

16 [2000] VSC 310 at [120].

17 [2003] VSC 108 at [267].

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18 [1999] FCA 903 at [34].

19 (1993) 117 ALR 393 at 406.

20 [2002] FCAFC 400 at [80].

21 [2003] FCA 50 at [920].

22 Burger King Corporation v Hungry Jack's Pty Ltd *[2001] NSWCA 187*.

23 Overlook Management BV v Foxtel Management Pty Ltd *[2002] NSWSC 17*.

24 Overlook Management BV v Foxtel Management Pty Ltd , *n 23 at [65]-[68]*.

25 Summers , " "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code" 54 Va L Rev 195 (1968).

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

27 Sheller JA, in Alcatel Australia Ltd v Scarcella (1998) *44 NSWLR 349* [PDF] and Adams J in Cubic Transportation Systems Inc v New South Wales *[2002] NSWSC 656*.

28 Burger King Corporation v Hungry Jack's Pty Ltd *[2001] NSWCA 187*.

29 Burger King Corporation v Hungry Jack's Pty Ltd , *n 28 at [187]*.

30 Steven Burton of Iowa University is credited with the recapture of foregone opportunities analysis of bad faith: see Burton , "Breach of Contract and the Common Law Duty to Perform in Good Faith" 94 Harv L Rev 369 (1980).

31 [2001] NSWSC 635 at [5].

32 Apple Communications Ltd v Optus Mobile Pty Ltd , *n 31 at [17]*.

33 Apple Communications Ltd v Optus Mobile Pty Ltd , *n 31 at [19]*.

34 Royal Botanic Gardens and Domain Trust v South Sydney CC (2002) *186 ALR 289*.

35 Royal Botanic Gardens and Domain Trust v South Sydney CC , *n 34 at 327*.

36 The magnitude of such a step was acknowledged by Giles JA in Vodafone Pacific Pty Ltd v Mobile Innovations Ltd *[2004] NSWCA 15* and Hansen J in Playcorp Pty Ltd v Taiyo Kogyo Ltd *[2003] VSC 108*.

37 Carter and Stewart, n 1 at 192-195.

38 Carter JW and Peden E , "Good Faith in Australian Contract Law" (2003) 19 JCL 155.

39 Carlin, n 2 at 105.

40 Carlin, n 2 at 109.

41 Carlin, n 2 at 115-118.

42 Carter and Stewart, n 1 at 192.

43 Renard Constructions (ME) Pty Ltd v Minister for Public Works (1992) *26 NSWLR 234* [PDF].

44 Burger King Corporation v Hungry Jack's Pty Ltd *[2001] NSWCA 187*.

45 Aiton Australia Pty Ltd v Transfield Pty Ltd (2000) *16 BCL 70*.

46 [2002] NSWSC 905 at [155].

47 Commonwealth Bank of Australia v Spira , *n 46 at [176]*.

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48 Peden E , "The meaning of contractual "good faith" " (2002) 22 Aust Bar Rev 235 and Peden E, n 3. But see Giles JA in Vodafone Pacific Ltd v Mobile Innovations Ltd *[2004] NSWCA 15*.

49 Peden E , "Incorporating Terms of Good Faith in Contract Law in Australia" (2001) 23 Sydney Law Review 222 at 231.

50 Vodafone Pacific Ltd v Mobile Innovations Ltd *[2004] NSWCA 15*.

51 Vodafone Pacific Ltd v Mobile Innovations Ltd *, n 50 at [196]*.

52 [2002] FCAFC 296 at [116].

53 GEC Marconi Systems Pty Ltd t/as EASAMS Australia v BHP Information Technology Pty Ltd *[2003] FCA 50*. See also Central Exchange Ltd v Anaconda Nickel Ltd *[2002] WASCA 94*, where Steytler J (with whom the other members of the Full Court agreed) also forcefully stated this at [64]: "One thing that is clear, however, is that principles of good faith 'do not block use of terms that actually appear in the contract'."

54 Vodafone Pacific Ltd v Mobile Innovations Ltd *[2004] NSWCA 15*.

55 Alcatel Australia Ltd v Scarcella (1998) *44 NSWLR 349* [PDF].

56 GEC Marconi Systems Pty Ltd t/as EASAMS Australia v BHP Information Technology Pty Ltd *[2003] FCA 50*. The McDonald's licences at issue in Far Horizons Pty Ltd v McDonald's Australia Ltd *[2000] VSC 310* contained an entire agreement clause but Byrne J was not required to determine whether the implied term was excluded by them (and did not do so).

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Biscayne Partners Pty Ltd v Vallance Corporation Pty Ltd *(at [135] and [136])*
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