

Incorporating Terms of Good Faith in Contract Law in Australia

DR ELISABETH PEDEN*

Synopsis

In the last ten years Australia has seen an increase in the number of contract cases in which parties are arguing that there is an obligation of 'good faith'. However, few such arguments are successful. What can be gleaned from the cases is that we are still not clear what exactly 'good faith' means. Furthermore, the method of incorporating good faith that is usually relied upon, namely the implication of a term, could in fact prove a hindrance rather than a positive force in the introduction of an obligation of good faith. This article will consider both these issues and conclude firstly, that 'good faith' is most easily understood in a negative sense, that is, courts are more comfortable identifying what is 'bad faith' or 'not in good faith' and secondly, that the use of good faith in the construction of contracts, rather than as an implied term, would be more acceptable to courts and therefore more accessible to parties.

1. Introduction

When *Renard Constructions (ME) Pty Ltd v Minister for Public Works*¹ (hereinafter *Renard*) was decided in 1992 there was some excitement about Priestley JA's seemingly controversial suggestion that there is an obligation of good faith and fair dealing in commercial contracts. The issue in that case was whether a contractual power in a building contract which permitted the principal to take over the builder's work was required to be exercised reasonably. In Priestley JA's view the requirement of reasonableness was clearly an implied term. He suggested the requirement could be either implied in fact or in law, and furthermore, that in some situations there is no real distinction between the types of implication.²

However, close on the heels of *Renard* was a decision of Gummow J in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd*,³ where a suggested implied term of good faith was rejected. *Renard* was adopted by the NSW Court of Appeal in *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney and anor*,⁴ in which Kirby P considered himself bound to do so.⁵ Nothing more was heard for some time and probably some people

* Lecturer, Faculty of Law, University of Sydney.

1 (1992) 26 NSWLR 234.

2 *Id* at 263.

3 (1993) 117 ALR 393.

4 (1993) 31 NSWLR 91.

5 *Id* at 93.

suspected that the whole issue had gone away. Academics were still keen on the idea and there were conferences held about what 'good faith' might mean and articles and books written.⁶

After about six years of hibernation, in recent times the notion of 'good faith' seems to be awakening, at least in the minds of parties, who are more likely to argue the requirement of good faith. There have been some decisions that have either expressly accepted an implied obligation of good faith in performance and the exercise of rights or have recognised there is a serious issue to be argued in the trial proper that such an obligation exists. Yet it can hardly be said that there is a generally accepted obligation of good faith that will be incorporated when the parties are silent on the issue. The courts are more prepared to uphold express terms requiring good faith.

This article will consider the way the good faith terms have been dealt with by Australian courts in the last few years. First, it is important to consider how good faith terms arise. They can either be expressly included by the parties, or incorporated by the courts, that is, as a term implied in fact or law. These approaches will be analysed and it will be suggested that they are not the preferable approach. To imply in fact a term requiring good faith is usually artificial. To imply such a term in law seems to blur the distinction between the purpose of implication in law and rules of construction. It will be suggested that, instead of implying terms of good faith, courts could use the method of construction, which has been used in other areas, such as when incorporating duties of cooperation. This would promote a more consistent approach.

The other way terms requiring good faith are incorporated into contracts is by the parties expressly including them in the terms of the contract. Recent Australian cases reveal that courts appear more willing to uphold these terms as sufficiently certain and complete. This is a further interesting development and contracting parties can increasingly expect good faith terms to be enforced.

2. *Incorporation of Terms Requiring Good Faith*

Terms requiring good faith can either be express terms, incorporated intentionally and expressly by the parties, or they can be implied by the courts. This second type is more interesting, since there seems to be an increasing tendency for courts to

6 For example, John W Carter & Michael P Furmston, 'Good Faith and Fairness in the Negotiation of Contracts' (1994) 8(1) and 8(2) *Journal of Contract Law* 1 and 93; Roger Brownsword, 'Two Concepts of Good Faith' (1994) 7(3) *Journal of Contract Law* 197; Jack Beatson & Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* (1995); Anthony Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *LQR* 66; Jenny Buchan, 'Good Faith? Good Business!' (1999) 2(5) *FLPR* 45; Ian B Stewart, 'Good Faith in Contractual Performance and in Negotiation' (1998) 72 *ALJ* 370; Tony Wilson, 'Good Faith and Best Endeavours in Finance Conditions' (1999) 14(1) *Australian Property Law Bulletin* 1; MSE Korotana, 'Walford v Miles and the Duty to Negotiate in Good Faith' (1999) *Business Law Review* 287; Jane Edwards, 'Negotiating Parties and Equitable Estoppel: Is there a duty of Good Faith?' (1999) 27(4) *ABLR* 300; Jane Stapleton, 'Good Faith in Private Law' (1999) 52 *Current Legal Problems* 1; Roger Brownsword, Norma J Hird & Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (1999). Literature in the US dates back much earlier.

incorporate obligations of good faith in this way. However, it will be suggested that there is a better way to incorporate good faith, namely, by construing the contract to require good faith. Cases where courts have rather implied terms of good faith will be considered to show their weak reasoning and failure to provide a consistent and convincing approach. These problems could be overcome if courts were to use construction as the way forward.

A. How Do Courts Impose Obligations of Good Faith When There is No Express Term?

If and when an obligation of good faith is incorporated into a contract by a court, it is most probably through the means of implication of a term. The traditional test of implication in fact comes from *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council*,⁷ where the Privy Council set out five overlapping criteria that need to be met by a term before it can be implied in fact, namely:

1. it must be reasonable and equitable;
2. it must be necessary to give business efficacy to the contract so that no term will be implied if the contract is effective without it;
3. it must be so obvious that 'it goes without saying';
4. it must be capable of clear expression;
5. it must not contradict any express term. This test has been adopted by the High Court on a number of occasions, including *Codelfa Construction Pty Ltd v State Rail Authority of NSW*.⁸

There has been a slight gloss put on the test. In *Byrne v Australian Airlines Ltd*,⁹ the High Court adopted the 'Deane test' from *Hawkins v Clayton*,¹⁰ namely, that where a contract is not a complete statement of the parties' bargain, then the *BP* test is not appropriate. Instead, where there is an informal or incomplete contract, the test is whether the term is 'necessary for the reasonable or effective operation of a contract of that nature in the circumstances of the case'.¹¹

Most commercial contracts would need to satisfy the *BP* test, because usually the contracts have been drafted by lawyers and look complete on their face. So, to imply a term requiring good faith in fact would require it to be necessary for the business efficacy of the contract and to be so obvious that it goes without saying.¹² In *Renard*, Priestley JA recognised that it might be difficult to suggest that such a

7 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266.

8 (1982) 149 CLR 337 at 347; see also *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 66, 117–118; *Corporation of the City of Adelaide v Jennings Industries Ltd* (1985) 156 CLR 274 at 282.

9 (1995) 185 CLR 410.

10 (1988) 164 CLR 539 at 573.

11 See John W Carter & Gregory J Tolhurst, 'Implied Terms: Refining the New Law' (1997) 12 *Journal of Contract Law* 152.

12 However, see *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 611 at 695–696, 701, where Finn J thought the 'Deane test' should apply, yet still would not imply the suggested term (paras 393, 415). See further discussion below.

term is necessary in order for the contract to be effective, that is, to work. He thought that it might be more appropriate to consider the term as one implied in law, or to view incorporation of good faith as a situation where the different types of implied term merged.¹³ However, he did also explain that the requirement of business efficacy could be satisfied in the particular case if the clause in question was looked at 'in a more general way'.¹⁴ This idea was not elucidated further, and it is unclear exactly what was meant. The tests of implication in fact can be criticised as being too uncertain,¹⁵ and to further increase the uncertainty by taking a 'general view of business efficacy' is not desirable. This view has not been adopted in later decisions.

In contrast, terms will be implied in law into all contracts of a particular type because of the nature of the contract, rather than the intentions of the parties. Where terms have been consistently implied then the onus is on the defendant to prove that the term should not be implied into a specific contract that fits within the category of contract before the court. However, the list of terms implied in law is not closed, and a plaintiff may try to convince the court that a new term should be implied in law, because it is 'necessary' for the type of contract, taking into account policy considerations. Thus, in *Liverpool City Council v Irwin*,¹⁶ the House of Lords considered it necessary to imply into high-rise council tenancies an obligation on the part of the council landlord to take reasonable care to keep common parts of the building in reasonable repair. So, it might be possible to argue that all contracts of a particular type require a term of good faith, because of the policy considerations involved. For example, it could be said that all landlords must exercise their rights to terminate leases in good faith, if it could be said that there were sufficiently cogent policy considerations to support it.

To date, there is no High Court decision about the appropriate method of incorporating an obligation of good faith into contracts. Most state courts approach the issue as one of implication, and very few arguments to imply such a term are successful. Part of the problem seems to be with the tests of implication. A way around this might be to use good faith in the construction of the contract, as will be discussed below.

13 Above n1 at 263.

14 *Id* at 258.

15 For example, it is said the term must be 'so obvious it goes without saying', which is taken from MacKinnon LJ's judgment in *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 206 at 227, where he invented the 'officious bystander' who would ask the parties whether they wanted to include a particular term. However, it is not clear what characteristics this bystander has. Furthermore, the phrasing of the question posed to the officious bystander could lead to different results. The test of 'business efficacy' is also problematic. To what extent should terms be implied to aid efficacy? Lord Wilberforce said that the degree of 'strictness [of the test] seems to vary with the current legal trend': *Liverpool City Council v Irwin* [1977] AC 239 at 253, whereas others state the term must be 'absolutely essential' before it will be implied: Kim Lewison, *The Interpretation of Contracts* (2nd ed, 1997) para 5.05 at 100–102. See also Michael Bryan & MP Ellinghaus, 'Fault Lines in the Law of Obligations: *Roxborough v Rothmans of Pall Mall Australia Ltd*' (2000) 22(4) *Syd LR* 636 at 640–648.

16 *Ibid*. This test has been adopted in Australia: *Byrne v Australian Airlines Ltd*, above n9; *Breen v Williams* (1996) 186 CLR 71; *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd* (1998) 43 NSWLR 104 at 122–123.

B. Recent Cases About Implied Terms of Good Faith

Since about 1996 there have been an increasing number of cases considering the incorporation of an obligation of good faith. They are arising in all contexts, such as tenders,¹⁷ commercial leases,¹⁸ licence agreements,¹⁹ contracts between football clubs and leagues,²⁰ contracts between business consultants and their sub-contractors,²¹ dealership agreements,²² contracts for supply of materials and labour,²³ and transport contracts.²⁴ What is interesting about these cases is the state of confusion about the appropriate way to incorporate an obligation of good faith into contracts.

The highest courts to decide cases on implied terms of good faith have been inconclusive on the method to be adopted. In *Renard*, Priestley JA suggested the obligation was a hybrid of implication of fact and law. Similarly, in *Hughes Aircraft Systems International v Airservices Australia*²⁵ Finn J stated that 'fair dealing' is a major (if not openly articulated) organising idea in Australian law. He held there was a term implied in fact and in law that the government body deal fairly with tenderers.

Other cases are completely ambiguous. For example, in *Alcatel Australia Ltd v Scarcella*²⁶ Sheller JA (with whom Powell and Beazley JJA agreed) held that an obligation to exercise contractual rights in good faith can be implied in commercial contracts.²⁷ However, it is completely unclear what method was used to achieve this conclusion. The trial judge had refused to imply a term of 'fair dealing' on the basis that it could not be implied in fact.²⁸

The facts of this appeal were simple. A landlord had commissioned a report from a fire engineer, who reported that work was needed for fire safety reasons. At the landlord's invitation the local council inspected the premises and found they

17 See eg, *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1; *Dalcon Constructions Pty Ltd v State Housing Commission* (1998) 14 BCLC 477.

18 *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Advance Fitness v Bondi Diggers Memorial and Sporting Club Ltd* (NSW Supreme Court, Austin J, 30 March 1999).

19 *Asia Television Ltd v Yau's Entertainment Pty Ltd* (Federal Court, Gyles J, 10 March 2000).

20 *News Ltd v Australian Rugby Football League Ltd* (1996) 135 ALR 33; *South Sydney District Rugby League Football Club Ltd v News Ltd*, above n12.

21 *Saxby Bridge Mortgages Pty Ltd v Saxby Bridge Pty Ltd* (NSW Supreme Court, Simos J, 26 May 2000).

22 *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) [21] ATPR 43,008 at ¶41-703.

23 *Shorrlong Pty Ltd v Northern Territory Housing Commission* (NT Supreme Court, Mildren J, 10 December 1999); *Howtrac Rentals Pty Ltd v Thiess Contractors (NZ) Limited* (Victorian Supreme Court, Gillard J, 21 December 2000).

24 *K & S Freighters Pty Ltd v Linfox Transport (Aust) Pty Ltd* (Federal Court, Finn J, 7 September 1999).

25 Above n17.

26 Above n18.

27 *Id* at 369. This vague and general approach has been adopted in other decisions. See eg, *Howtrac Rentals Pty Ltd v Thiess Contractors (NZ) Limited*, above n23 at paras 422–423, citing *Alcatel*, above n18.

28 Quoted in *Alcatel*, above n18 at 361.

did not comply with requirements laid down in legislation and so the tenant would need to vacate the premises. The tenant wanted to challenge the council's findings, but the landlord would not permit the tenant to use its name to sue. The tenant argued that there was an implied term in the lease that the landlord would cooperate with the tenant in the bringing of the action, which really amounted to a claim that there was an implied term of fair dealing.

Sheller JA briefly summarised the law around the world²⁹ as decided in cases, and commentary on the law, which was on the whole supportive of the obligation of good faith. He held there was no reason why a duty of good faith should not be implied as part of the lease. However, on the facts, the landlord was not acting unconscionably or in breach of an implied term of good faith, where the landlord merely took steps to ensure that the requirement for fire safety contained in the expert's report should be put in place. Sheller JA stressed the commercial nature of the relationship and said:

In a commercial context it cannot be said, in my opinion, that a property owner acts unconscionably or in breach of an implied term of good faith in a lease of the property by taking steps to ensure that the requirements for fire safety advised by an expert fire engineer should be put in place.³⁰

C. *Terms Implied in Fact*

Some cases have expressly stated that implication in fact may work to imply such a term. However, it is difficult to apply the test of implication in fact strictly and to reach that conclusion. One example is provided by *Advance Fitness Corporation Pty Ltd v Bondi Diggers Memorial and Sporting Club Ltd*.³¹ There, the plaintiff, the defendant's tenant, was seeking an order that the defendant provide its consent to permit the plaintiff to carry out fire safety work, so that the council would not issue an evacuation order and so the plaintiff could remain in occupation. One argument was that the defendant was obliged by an implied contractual term to cooperate or not to refuse to cooperate. Austin J discussed what he saw as the relevant principles.³²

He stated that the *BP* test was the appropriate test for implication in fact, and that an obligation to cooperate can be implied using this test, as it was in *Mackay v Dick*.³³ He thought that this was similar to the way a term might be implied requiring good faith or reasonableness in the performance of obligations and the

²⁹ Id at 363–369.

³⁰ Id at 369–370.

³¹ Above n18. For another example with a similar approach, see *Dalcon Constructions Pty Ltd v State Housing Commission*, above n17. There the question was whether a tender process gave rise to a contract having a term which required the Commission to act honestly, impartially and in good faith in selecting the successful tenderer. Dalcon was the lowest tenderer for a project but was not awarded the job. Templeman J did not think such a term could be implied in fact, as there were express terms to the contrary. In any event, Templeman J did not think such a term would have been breached on the facts.

³² Id at paras 95–100, 118–123.

³³ (1881) 6 App Cas 251.

exercise of rights.³⁴ He referred to Priestley JA's decision in *Renard*, Finn J in *Hughes* and the NSW Court of Appeal in *Alcatel v Scarcella*.

However, Austin J held 'this attempt to imply a term on the basis of *Mackay v Dick* fails, because compliance with the Council's fire safety requirements cannot be classed as something the parties have agreed 'shall be done'.... The express terms of the [lease] deal with the rights and obligations of the parties with respect to repairs and compliance with the requirements of statutory authorities. Therefore there is no room here for the operation of *Mackay v Dick*.³⁵ His Honour further held that even if there was an implied duty of good faith, he did not think the defendant's conduct in the commercial context was inconsistent with that duty. So here, Austin J was suggesting that an obligation to cooperate or perform in good faith was to be implied in fact, rather than being a principle or implied term relevant to all contracts.

Courts seem to be encountering the difficulty Priestley JA foresaw,³⁶ namely, that it is difficult to show that a term that the parties perform in good faith is 'necessary for the business efficacy' of the contract, or 'so obvious it goes without saying', since the contract can 'work' if the parties perform their obligations in their own interests. Occasionally, this is made explicit, for example, in *Saxby Bridge Mortgages Pty Ltd v Saxby Bridge Pty Ltd*.³⁷ There, Simos J was asked to imply a term in a contract between a main insurance and business consultant and their sub-contractors, that the parties would deal with joint clients 'in good faith in the interests of both of them'. His Honour declined to imply the term. He did not think the term was necessary for business efficacy or so obvious it went without saying.³⁸ Simos J did not consider whether such a term could be implied in law, but it is unlikely this would be the case, since there would be no policy reasons why such a term should exist, since it could operate to the disadvantage of the client.

D. Terms Implied in Law

Can good faith terms be more easily implied in law? As noted above, the test for implication in law depends on the classification of the specific contract into a class

34 *Advance Fitness v Bondi Diggers*, above n18 at para 97.

35 *Id* at para 121.

36 Above n1 at 258.

37 Above n21.

38 *Id* at paras 61–62. He also thought it could not be implied because the subject matter was never 'the subject of discussion or correspondence between the parties' at para 61. This is incorrect in principle, since terms are often implied even though the parties have not discussed them. Indeed a failure to discuss a term can often be explained on the basis that the term is 'so obvious it goes without saying'. See also *South Sydney District Rugby League Football Club Ltd v News Ltd*, above n12 at para 415, where Finn J would not imply a term 'that the NRL Partners would evaluate fairly and in good faith which clubs would be offered participation in the 2000 season and beyond' because it was not necessary for the reasonable or effective operation of the contract in the circumstances, as it would have changed the intended character of the contractual relationship. While Finn J stated that terms requiring good faith might be implied in law into particular classes of contract, particularly contracts of a commercial nature (para 393), he did not think the term could be implied in law either, but did not provide detailed reasons (para 415).

of contracts, for which the particular implied term has sufficient positive policy justifications. Courts are reluctant to imply new terms in law. This is partly because legislation covers many important areas and probably partly because courts are wary of creating new obligations that will catch a vast number of contracts.

Some judges have tried to use implication in law to incorporate an obligation of good faith. For example, Burchett J was prepared to imply in law an obligation of good faith in *News Ltd v Australian Rugby Football League Ltd and Others*.³⁹ I say he 'implied the obligation in law' because he cites the test from *Byrne v Australian Airlines Ltd*.⁴⁰ 'Many of the terms now said to be implied by law in various categories of case reflect the concern of the courts 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.' He also states that the term is appropriate to agreements made between parties involved in the conduct of a sporting competition.⁴¹ However, the actual term argued for and accepted was that the specific clubs 'promised to act in good faith with fair dealing towards the NSWLR and ARL',⁴² which is not worded like a term implied in law, but more like a term implied in fact, because of the specific detail. Irrespective of this technicality, Burchett J was prepared to imply what he saw as a term in law.

A few other judges have suggested that a term requiring good faith performance could be implied in law. *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd*⁴³ was a case that was run on s51AC of the *Trade Practices Act 1974* (Cth)⁴⁴ and an obligation of good faith. Subaru terminated the plaintiff's dealership with 13 months notice, ostensibly because the plaintiff was not prepared to abide by a new '6 star revitalisation program' Subaru wanted implemented in all dealerships. The plaintiff claimed⁴⁵ this was either in breach of s51AC or in breach of an implied term not to exercise any power conferred by the agreement including the power of termination otherwise than in good faith.

Finkelstein J acknowledged⁴⁶ that recent decisions suggested that in appropriate contracts and perhaps even in all commercial contracts, such a term will ordinarily be implied as a legal incident of the relationship. Such a term would require a contracting party to act in good faith and fairly in the exercise of a power conferred by the contract. Such an obligation would require a party not to act capriciously. It

39 Above n20.

40 Above n9 at 450 (McHugh & Gummow JJ).

41 Above n20 at 120.

42 *Ibid.*

43 Above n22.

44 Section 51AC prohibits unconscionable conduct by corporations against persons and vice versa. Conduct which is unconscionable is to be determined by all the circumstances of the case. Section 51AC(3) and (4) list 11 factors which the court may take into account in making a determination. The section applies to both the supply and acquisition of goods but the transaction must not exceed \$1million and the provision does not extend to public companies. The rationale appears to be that large corporations will have sufficient resources to acquire full information and protect their own interests.

45 Above n22 at para 8.

46 *Id* at para 34, citing *Renard*, above n1; *Hughes*, above n17; and *Alcatel*, above n18.

would not operate so as to restrict actions designed to promote the legitimate interests of that party. Finkelstein J did not define exactly what the content of the restriction on the exercise of a contractual power to terminate would be, but he did not think it had been exceeded in the case before him, especially since 13 months' notice had been given. This case has been cited with support by Finn J in *South Sydney District Rugby League Football Club Ltd v News Ltd*.⁴⁷

However, these cases do not explain the reasoning and the content of the obligation. And in no case has the obligation been breached. This either suggests that courts are very antagonistic towards the notion of good faith, or the approach of implying a term is not conducive to incorporating good faith into contracts. The former suggestion does not seem warranted, since there are several statements by judges that good faith is an important and integral part of contract law.⁴⁸ The second possibility requires an alternative approach. If courts are prepared to 'imply' an obligation of good faith into all commercial contracts and if as suggested the test for implication will not always be made out, then arguably this means they are in fact more concerned with construction rather than implication, since all contracts must be construed and notions of 'good faith' can be incorporated at that stage, instead of having to satisfy tests of implication.

E. Better Approach — Construction

It will generally be difficult to incorporate good faith by implying a term in fact and satisfying the *BP* test, since the contract will be able to operate or be effective without it. An implied in law approach is also flawed. The test for implication in law of a new term is that the term is necessary for the type of contract. This requires an analysis of various and often competing policy considerations prior to a successful implication. Courts are always very particular about narrowing the type of contract to which the term will apply. In *Liverpool City Council v Irwin* the contract type was high-rise council tenancies. Therefore, it is impossible to imply a term in every commercial contract no matter what type is involved. There are different policy considerations for tenancies, unit trusts, guarantees etc.

No terms are implied into all contracts.⁴⁹ If the courts want the notion of good faith to apply in all situations, what they should be looking to do is use good faith as a principle or tool of construction. That is, to construe all contracts on the basis that there is an expectancy of good faith in all terms, unless there is something explicit to suggest otherwise. Unlike terms implied in fact or law, which apply specifically to a contract or a class of contracts, rules of construction apply generally to all contracts. For example, the doctrine of frustration is based on construction.⁵⁰ So too, good faith should be.

47 Above n12 at para 393.

48 See, for example, *Renard*, above n1 at 258–263 (Priestley JA); *Hughes Aircraft Systems International v Airservices Australia*, above n17 (Finn J); The Honourable Justice Steyn, 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?' [1991] *Denning Law Journal* 131.

49 For a contrary view see Bryan & Ellinghaus, above n15 at 651–654.

50 See *Davis Contractors Ltd v Fareham UDC* [1956] AC 696 at 729; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*, above n8 at 357, 376, 408.

This approach would have several advantages. There would be no uncertainty as to whether a term is implied or not and no 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 and factual matrix of the contract in question.

F. Cooperation and Good Faith

There is some precedent for using concepts like good faith as principles of construction, instead of implied terms. Cooperation has been used in this way.⁵¹ *Mackay v Dick*⁵² has been accepted by later cases as providing that there is a general obligation to cooperate or do all that is reasonably necessary to facilitate performance of a contract.⁵³ The court did not imply a term to cooperate in *Mackay v Dick*. Instead, the case was about the appropriate construction of the contract. There was a contract for the sale of a custom made digging machine, which provided for the testing of the machine before the purchase money was due. The defendant would not allow the machine to be tested and refused to pay for it. It was held that the defendant had an obligation to cooperate to allow the machine to be tested, and as the defendant had breached that obligation it could not complain that the machine did not work the way required and was obliged to pay. The court 'construed' the contract to determine what obligations the parties had. The clause allowing testing was for the benefit of the defendant, who chose not to take advantage of it and so was not later allowed to complain.

Later cases have not distinguished between the notions of cooperation and good faith. They seem to be treated as elements of the same thing. There are more recent cases than *Mackay v Dick* that imply terms of cooperation. For example, in *Australis Media Holdings v Telstra Corp*⁵⁴ the NSW Court of Appeal held that the duty of cooperation can be incorporated as a term implied in law in relation to all contracts or all contracts of a particular type. Yet other cases use the word 'imply', but seem to mean it in the sense of 'infer' or 'construe'. For example, in *WMC Resources Ltd v Leighton Contractors Pty Ltd*,⁵⁵ Anderson J was required to determine whether an express clause required a prior action by the parties. He held that both parties need to cooperate to achieve this aim, which was 'simply an application of the rule that each party to a contract impliedly agrees to do everything necessary on his part to enable the other party to have the benefit of the contract'.⁵⁶

51 See Peden, 'Cooperation in English Law: to construe or imply?' (2000) 16 *Journal of Contract Law* 56.

52 Above n33.

53 For example, *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 607: 'It is easy to imply a duty to cooperate in the doing of acts which are necessary to the performance by the parties or by one of the parties of fundamental obligations under the contract'; *Butt v McDonald* (1896) 7 Q.L.J 68 at 70-71 (Griffith C.J).

54 Above n16.

55 [1998] WASC 280.

56 Id <www.austlii.edu.au/au/cases/wa/WASC/1998/280.htm> at 14.

In relation to good faith, there have so far only been cases implying terms. It would be better for courts to use good faith as a basis for construction, as cooperation is used, instead of implication. On the whole, good faith works in a negative sense, in that it controls the exercise and possible breaches of positive obligations and rights contained in a contract. This gives further weight to the argument that good faith is better seen as a rule of construction. The way a so-called 'obligation' of good faith works is to require parties not to breach positive obligations, for example, by behaving in a way that is contrary to the necessary meaning of the positive obligations. For example, if it is said that in a contract for an exclusive licence there is an obligation to perform in good faith, there is necessarily a prohibition on giving use of the premises to another. Effectively, the positive obligation of the exclusive licences is 'construed' in good faith to require a prohibition of the breach of the licence agreement. This would suggest the only situation when 'good faith' needs to be implied as an actual term is when it is going to be used as a positive obligation requiring some positive action, rather than merely restricting the destruction of positive obligations under a contract. So, for example, if the case of *Renard* is considered once more, how would this approach affect the result? There was already the express terms allowing the principal to take over the builder's work. This could have been construed so that the power could only be exercised in good faith. There would be no need to hurdle the tests of implication to incorporate a term requiring good faith. Similarly, in *Alcatel*, the Court of Appeal could simply have said that the contractual rights would be construed to require them to be exercised in good faith, rather than suggesting there is such an implied contractual obligation. Cases would reach the same result, yet without the confused and often inappropriate reasoning that includes implication of terms of good faith.

3. *Interpretation of Express Terms to Negotiate and Perform in Good Faith*

If obligations of 'good faith' are incorporated into contracts, what meaning can be assigned to them?

A. *Basic Approach to Interpretation: Are Such Terms Certain?*

Courts were originally quite nervous about the concept of an express obligation of parties to act in good faith in a contract.⁵⁷ *Coal Cliff Collieries*⁵⁸ was a significant decision in 1991, where the NSW Court of Appeal had to consider whether the express term requiring the parties to continue negotiations in good faith could be

57 There are legislative requirements in some circumstances to negotiate in good faith. See eg. *Native Title Act* (Cth) 1993 s31. and discussion on this section in *Brownley v State of Western Australia* (1999) 95 FCR 152. Other legislation also requires a standard of good faith in the performance of certain activities. See eg. *Metropolitan Region Town Planning Scheme Act* (WA) (1959) s36(4)(b). which was discussed in *Bond Corporation Pty Ltd v Western Australian Planning Commission* (1999) 108 LGERA 235; [1999] WASC 157.

58 *Coal Cliff Collieries P L v Sijehama P L* (1991) 24 NSWLR 1; *Australis Media Holdings v Telstra Corp.* above n16.

upheld or whether it was too uncertain or illusory. The opening words of the heads of agreement included:

The parties will forthwith proceed in good faith to consult together upon the formulation of a more comprehensive and detailed joint venture agreement.

On the facts the term was struck down as too uncertain. However, Kirby P was not completely hostile to the notion. He believed that in certain situations there could be an enforceable obligation to negotiate in good faith. The contract would have to provide some indication of what might amount to a breach of that obligation. For example, if the parties were meant to attend certain meetings etc, then it would be clear if one party completely refused or was ambivalent that there had been a breach of that obligation.

Along with the latest trend to consider seriously and sometimes to imply obligations of good faith, express terms requiring good faith are being construed to give them content. For example, in *Aiton v Transfield*,⁵⁹ Einstein J was prepared to hold a clause requiring negotiation in good faith to be certain and valid. In *Aiton*, the plaintiff was suing in relation to certain misleading and deceptive representations made while negotiating contracts to construct a power project.⁶⁰ The defendant sought a stay of those proceedings because it said that express procedures of dispute resolution in the contract were not followed before the proceedings were commenced, even though the defendant was at all times ready and willing to do everything to help the procedures. Einstein J dismissed the application because of his interpretation of section 28 of the contract.

Section 28.1 provided:

The Purchaser and Supplier shall make diligent and good faith efforts to resolve all Disputes in accordance with the provisions of Section 28.1 [General] before either party commences mediation, legal action or the expert Resolution Process, as the case may be.

The Designated Officers shall meet in person and each shall afford sufficient time for such meeting (or daily consecutive meetings) as will provide a good faith, thorough exploration and attempt to resolve the issues. If the Dispute remains unresolved 5 Business Days following such last meeting, the Designated Officers shall meet at least once again within 5 Business Days thereafter in a further good faith attempt to resolve the Dispute.

Einstein J held that clause 28.1 amounted to an agreement to negotiate in good faith.⁶¹ The issue was whether it was enforceable and if so, whether it had been complied with. He thought it was enforceable. However, it was attached to a mediation clause. Clause 28.2 provided that 'If the Dispute is not resolved pursuant to the process established in Section 28.1 [General] either the Purchaser

59 (2000) 16 BCL 70; (1999) 153 FLR 236 (Einstein J).

60 The case was being run on *Trade Practices Act 1974* (Cth) ss52, 53 and *Fair Trading Act 1987* (NSW) ss42, 44 or *Fair Trading Act 1987* (SA) ss56, 58.

61 Above n59 at para 40.

or Supplier shall submit the same for mediation and the parties expressly agree' to the process set out. Importantly, s28.2(h) provided: 'The Parties agree to use all reasonable endeavours in good faith to expeditiously resolve the Dispute by mediation.' If the mediation process was not successful, then either party could use an 'Expert Resolution Process' provided for in s28.3. Einstein J thought the mediation agreement was unenforceable as it did not spell out how the mediators' costs were to be dealt with. As this agreement could not be severed from the agreement to negotiate, it was all unenforceable.

The plaintiff suggested⁶² that the requirement of 'good faith' in clause 28 was not sufficiently certain or precise. Einstein J disagreed. In doing so he considered whether the requirement of good faith in dispute resolution clauses creates obligations which are enforceable in law. He distinguished *Coal Cliff* and other cases where the agreement was one to negotiate in good faith, since the case before him concerned an agreement that supplied a requirement to negotiate in good faith if there was a dispute. He thought this was more akin to a requirement to perform in good faith.⁶³

Einstein J held that for an agreement to mediate in good faith to be enforceable, it must be sufficiently certain. Clause 28 did not specify the mediator's remuneration or what should happen if the mediator declined appointment. His Honour did not think it was possible to imply a term that the parties share the reasonable remuneration of the mediator.⁶⁴

The decision is interesting in that Einstein J was prepared to uphold an obligation of good faith and even provide some content to that obligation, which most judges shy away from doing. It was only because of the construction of the contract as a whole that the clause was unenforceable.

62 *Id* at para 34.

63 However, where the clause is not as express, arguments that what has been agreed amounts to an agreement to negotiate can be unsuccessful. See eg, *Tobias v QDL Ltd* (NSW Supreme Court, Simos J, 12 September 1997) where Simos J held that even if there were such an agreement, which he rejected, it has not been breached in the circumstances. See also *Michael O'Brien Catering Pty Ltd v Peter Rowland Catering Pty Ltd* (Supreme Court of Victoria, Mandi J, 19 November 1997) at 30, where Mandie J held there was no binding contract to negotiate in good faith, 'the parties having simply agreed to leave the problems of their relationship created by a management contract for future commercial negotiation'. In *Vivian Fraser & Associates Pty Ltd v Shipton* [1999] FCA 60 Lindgren J held there was no contract to negotiate in good faith on the facts before him.

64 He thought the appropriate test of implication was that from *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council*, above n7 at 26 which was applied in *Codelfa Construction Pty Ltd v State Rail Authority of NSW*, above n8 at 347 (Mason J). He thought that the suggested implied term failed because it was not 'so obvious that it went without saying', since he could think of other ways in which the parties might have intended to remunerate the mediator. For example, they might have wanted a similar regime to that provided in clause 28.3 for experts. Alternatively, they might have wanted the mediator to have had power to determine the costs (see para 67). The *BP* test suggested that the 5-point test had elements that might overlap. Therefore it would be unlikely that a term would fall at just one of the heads.

Another slightly different example comes from *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*,⁶⁵ where Ipp, Steytler and Wheeler JJ were faced with a dispute over a mining contract which contained Clause B1.1.5:

The successful operation of this Contract requires that [Thiess] and [Placer] agree to act in good faith in all matters relating both to carrying out the works, derivation of rates and interpretation of this document.

The WA Court of Appeal took this to mean in the context of the contract that the parties were meant to agree on rates in advance of work done and they were meant to cooperate in the establishment of rates based as far as reasonably possible on actual costs. So, Thiess was meant to disclose all facts relevant to the establishment of rates based on actual costs.⁶⁶ This was the 'content' of the obligation of good faith. When Thiess knowingly misrepresented to Placer that certain costs were its genuine estimate of costs, but they actually included profits, this was in breach of the express term to act in good faith.⁶⁷

So, an express term requiring good faith in negotiation or mediation needs to provide enough detail to be considered certain. An express term requiring good faith in performance seems to require less detail. The terms will then be interpreted to give them meaning. More detail helps, but is not necessarily needed. Having said this, is it better to draft a contract with a term requiring good faith performance, or to leave it open for the courts to imply one when and where necessary? A reason why contracting parties might include an express term of good faith is to provide certainty to the contract, especially since the term is more likely to be upheld today, providing there is enough detail to convince the court. Furthermore, the term can provide for the more harmonious operation of the contract and will avoid later argument about the implication of such a duty. If the contract is an international one, then Australian parties should keep in mind that European parties usually expect such an obligation and so may require it to be included.⁶⁸ However, there are also reasons why parties may choose not to include an express term of good faith. For example, lawyers might suggest to commercial clients that it is preferable not to take a particular good faith approach to the contract, and that rather they should leave their options open as to whether an aggressive or more cooperative strategy is optimal.⁶⁹ This type of strategy would not be as readily available if the courts used good faith in the construction of the

65 *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (WA Supreme Court, Ipp, Steytler & Wheeler JJ, 14 April 2000).

66 *Id* at para 35.

67 *Id* at para 37.

68 See eg, UNIDROIT Principles of International Commercial Contracts, arts 1.7, 4.8, 5.3, 6.2.3; United Nations Convention on Contracts for the International Sale of Goods, art 7; French Civil Code, art 1134(3); *German Bürgerliches Gesetzbuch*, ss157, 242; *Unfair Terms in Consumer Contracts Regulation*, SI 1994 No 3159 (UK).

69 However, there is strong empirical research to suggest that commercial parties themselves prefer a cooperative approach and that this is beneficial to all contracting parties in terms of long term relationships. See eg, Hugh Collins, *Regulating Contracts* (1999) at ch6; Roger Brownsword, *Contract Law — Themes for the Twenty-First Century* (2000).

contract. Then, the context of the contract as a whole would dictate the form and content of the obligation of good faith.

B. What Does ‘Good Faith’ Mean?

At present it might seem easy to agree that good faith is ‘a concept which means different things to different people in different moods at different times and different places’.⁷⁰ While there has been much academic comment on the possible meaning of ‘good faith’,⁷¹ there have been few judges brave enough to postulate the possible content of obligations of good faith. This is understandable, since the courts are not convincing about the appropriate method of incorporating such obligations. However, there have been some recent indications of what the obligation may mean.

In *Aiton*, Einstein J gave an overview of the notion of ‘good faith’ in the context of negotiating and mediating in contract law and statutes. While conscious of the need for courts to refrain from restricting themselves with exhaustive definitions, Einstein J was prepared to provide a summary of the ‘core elements’ of an obligation to negotiate or mediate in good faith, which he drew from cases, statutes and commentary. A party contracting to negotiate or mediate in good faith is obliged:⁷²

- (1) to undertake to subject oneself to the process of negotiation or mediation (which must be sufficiently precisely defined by the agreement to be certain and hence enforceable).
- (2) to undertake in subjecting oneself to that process, to have an open mind in the sense of:
 - (a) a willingness to consider such options for the resolution of the dispute as may be propounded by the opposing party or by the mediator, as appropriate;
 - (b) a willingness to give consideration to putting forward options for the resolution of the dispute.

He also stated that the obligations of a party who contracts to negotiate or mediate in good faith does not require that party to:⁷³

70 Bridge, ‘Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?’ (1984) 9(4) *Canadian Business Law Journal* 385 at 407.

71 Such comment began years ago and included Lucke, ‘Good Faith and Contractual Performance’ in Paul D Finn (ed), *Essays on Contract* (1987) at 162, where he suggests good faith does not require altruism, but rather loyalty to the contract. More recently, Stapleton has suggested the core principle of ‘good faith’ (which spans all areas of private law where the concept is used) is ‘tempering of advertent pursuit of self-interest where this is unconscionable for specific reasons: because it was dishonest, deliberately contradictory or deliberately exploitative’: above n6 at 35. See also Summers, ‘“Good Faith” in General Contract Law and the Sales Provisions of the Uniform Commercial Code’ (1968) 54 *ValR* 195; Stephen Burton, *Judging in Good Faith* (1992).

72 Above n59 at para 156.

73 *Ibid.*

- (a) act for or on behalf of or in the interests of the other party;
- (b) act otherwise than by having regard to self-interest.

Einstein J said⁷⁴ ‘the matter should be approached as a question of principle, it being undesirable to attempt to formulate a list of factual indicia suggesting compliance or non-compliance with the obligation to mediate in good faith.’ He thought the concept acquires substance from the particular events that take place to which it is applied: ‘the standard must be fact-intensive and is best determined on a case-by-case basis using the broad discretion of the trial court.’⁷⁵ However, it seems that courts will allow normal reasonable business behaviour. They will try to protect proprietary rights. Yet they will not tolerate unfair dealing or capricious behaviour.

Even more recently, in *South Sydney District Rugby League Football Club Ltd v News Ltd*⁷⁶ Finn J took the opportunity (in obiter) to canvass the possible meaning of ‘good faith’. He states that⁷⁷ ‘recent decisions suggest that the implied duty of good faith and fair dealing ordinarily would not operate so as to restrict decisions and actions, reasonably taken, which are designed to promote the legitimate interests of a party and which are not otherwise in breach of an express contractual term’. He further added that⁷⁸ ‘the supposed uncertainty with “good faith” terminology has not deterred every State and Territory legislature in this country from enacting into domestic law the provisions of Article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods.’⁷⁹

These comments suggest that a different approach would be more realistic and certain. If the obligation of good faith were incorporated into contracts through construction of individual contracts, then the meaning of good faith is easier to perceive. Naturally, it will never be a completely concrete idea. Yet that is nothing new for the law, since it is comfortable with other ‘fuzzy’ concepts or norms, such as ‘negligence’ and ‘reasonableness’. Used in this way, good faith would mean different things depending on the context of the particular contract. It would not be surprising that many commercial contracts would not require parties to demonstrate much good faith, since in the context of a complex, lawyer-drafted contract strict performance might be expected. For this reason, it might be said the

74 Id at para 128.

75 Id at para 129.

76 Above n12.

77 Id at para 394, citing *Alcatel, Garry Rogers, Asia TV, Advance Fitness and Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310. This idea is also close to Finn J's idea of unconscionable conduct: see Finn, ‘Unconscionable Conduct’ (1994) 8 *Journal of Contract Law* 37.

78 Above n12 at para 393, citing as an example *Sale of Goods (Vienna Convention) Act 1986* (NSW).

79 The *Trade Practices Act* has recently been amended to include s51AC which prohibits unconscionable conduct by corporations against persons and vice versa. There may often be an overlap between this section and good faith. See eg, *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd*, above n22.

obligations of good faith that were found in the cases mentioned above, were not breached.

Most basically, by using the obligation to perform in good faith as a principle of construction the courts are merely required to ensure that the parties have genuinely adhered to the bargain which they entered into. This will require an examination of the whole contract and the underlying intentions. Strict rights may not be adhered to, if in the context of the contract as a whole, this would subvert the character of the contract. Most cases that discuss the concept do so in terms of negatives, that is, what is not in breach of good faith.⁸⁰ This makes sense, since it is the context of the contract read as a whole that will indicate what is appropriate and what is not.

4. Conclusion

Until the High Court has the opportunity to decide how such obligations should be incorporated and what 'good faith' means, we are left with some uncertainty in the law. However, there are a few conclusions that can be made. First, an express term in a contract requiring good faith, either in negotiation or performance, is likely to be considered certain and interpreted to give it meaning. So, care should be taken when drafting express contractual terms requiring good faith. Second, where there is no express term, a term might be implied requiring good faith. There does not seem to be a restriction as to the type of contracts in which such a term might be implied. Whether the term had been breached will depend on the circumstances of the case, since 'good faith' depends on the context of the whole contract. If, however, the method of implication of terms of good faith is replaced with the more logical and consistent approach of using construction, then all contracts would be approached in the same way. This would satisfy the idea that good faith is a concept that is applicable to all contracts. Yet at the same time, parties could protect themselves by expressly stating what sort of performance was required and the context of the contract as a whole would influence the court's decision as to whether there was in fact a breach of an obligation of good faith.

80 This is also the way good faith is interpreted in other contexts. For example, there is an equitable obligation on mortgagors to act in good faith when selling a mortgaged property. See eg. *Forsyth v Blundell* (1973) 129 CLR 477 at 481. Cases usually define what is *not* a breach of this obligation. See eg. *A Legudi and Sons (Victoria) Pty Ltd v VL Finance Pty Ltd* (Supreme Court of Victoria, Hansen J, 30 April 1997); *Adamse v Broadway Credit Union Ltd* (1999) NSW ConvR 55-876. Good faith can therefore be contrasted with other equitable principles, such as unconscionability and undue influence that are worded in a negative way to begin with and focus on negative conduct, rather than setting a positive standard. This is similar to Summers' view: above n71.