CRITIQUE AND COMMENT

GOOD FAITH: WHERE ARE WE AT?

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*[Considerable confusion and uncertainty exists regarding which classes of contracts and in which circumstances a duty of 'good faith' operates. Traditionally, the duty did not apply to commercial contracts, but a review of the post-*Renard *authorities indicates otherwise. The situation is not clarified by the varied approaches taken by the courts, which often blur the distinction between purposive interpretation as opposed to implication by law or implication in fact. This article suggests that the commercial purpose test should be a fundamental consideration in all contractual dealings. This test has been given a clear mandate by the High Court, and it will, in most cases, lead to the most appropriate good faith outcome achievable in any particular case.]*

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I GOOD FAITH: SETTING THE COMMERCIAL CONTRACT APART

> [F]or a number of reasons, some to do with the work of legislatures, some to do with judicial law-making, and some to do with the temper and spirit of the times, we can no longer say that, in all but exceptional cases, the rights and liabilities of parties to a written contract can be discovered by reading the contract.[1]

Nothing truer can be said of the duty of 'good faith' in contract law. One commentator has even remarked that

> [g]ood faith in the performance of contracts is one of those annoying areas of law that keeps appearing in cases, and yet even with decisions from appeal courts, we seem no closer to a resolution of exactly when an obligation of good

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1 A M Gleeson, 'Individualised Justice — The Holy Grail' (1995) 69 *Australian Law Journal* 421, 428.

> faith in the performance of contracts will be incorporated, and exactly what that obligation will impose.[2]

The material available on the issue, whether judicial, academic or otherwise, is so voluminous that one is at pains to know where to dive in.

Yet since the watershed case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works* ('*Renard*'),[3] which paved the way for the emergence of a good faith doctrine, a steady transition related to good faith obligations appears to be occurring in the way contractual performance is monitored. Time and time again, Victorian courts have been called upon to determine contractual disputes in which it has been asserted by one or several of the parties that good faith obligations are enforceable. Why then is the law in this area prone to such confusion and uncertainty?

Since *Renard*, *Burger King Corporation v Hungry Jack's Pty Ltd* ('*Burger King*')[4] and *Hughes Aircraft Systems International v Airservices Australia*,[5] whole forests have been felled to produce judicial and academic writing on the meaning of good faith in contract law. This task has been tended to by a number of commentators, all of whom acknowledge that such definition awaits authoritative determination by the High Court.[6] There is much academic disapproval and criticism of the implications of a duty of good faith in the manner derived from *Renard*, which suggests that *Burger King* and *Vodafone Pacific Ltd v Mobile Innovations Ltd* ('*Vodafone*')[7] (to which I will refer again shortly) do not adhere to the fundamental principles underlying Australian contract law and, in particular, that the decisions display a fundamental disregard for and misunderstanding of the law relating to both implication in law and in fact.[8] I note this for completeness but do not wish to dwell on these criticisms. There is a bewildering array of authorities and academic views on the topic.

What I would like to do is make some observations on the development of dispute resolution of commercial contracts, including some thoughts that have occurred to me when reflecting on the good faith question as it applies to such

2 Elisabeth Peden, 'Good Faith in the Performance of Contract Law' (2004) 42(9) *Law Society Journal* 64, 64.

3 (1992) 26 NSWLR 234.

4 (2001) 69 NSWLR 558.

5 (1997) 76 FCR 151.

6 The High Court declined to decide the issue in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 because it was unnecessary to do so in that case. Special leave to appeal from the New South Wales Court of Appeal's decision in *Burger King* was granted, but the appeal did not proceed: Transcript of Proceedings, *Burger King Corporation v Hungry Jack's Pty Ltd S157/2001* [2002] HCATrans 180 (19 April 2002). See also N C Seddon and M P Ellinghaus, *Cheshire and Fifoot's Law of Contract* (LexisNexis Butterworths, 9th ed, 2008) [10.43].

7 [2004] NSWCA 15 (20 February 2004) (special leave to appeal to the High Court was refused: Transcript of Proceedings, *Mobile Innovations Ltd v Vodafone Pacific Ltd* [2004] HCATrans (10 December 2004)).

8 For a summary of the various academic views and of the differing approaches to the implication and construction debate, see Marcel Gordon, 'Discreet Digression: The Recent Evolution of the Implied Duty of Good Faith' (2007) 19(2) *Bond Law Review* 26.

contracts. My observations relate primarily to the modern approach to interpreting and implying terms in contracts and how good faith fits into that equation.

At the very least, it appears that in some agreements, a good faith obligation will be more readily found than in others. This will depend on the terms in which the power is expressed. In the case of *Tote Tasmania Pty Ltd v Garrott*, three types of contractual powers were identified, without purporting to be exhaustive:

> One is a provision conferring a power in an agreement, such as a partnership agreement, which is concerned with co-operation between the parties to produce a result which benefits all the parties to the contract. In such an agreement, a court might readily imply an obligation to act in good faith in that the party upon whom the power is conferred must have regard to the interest of all the parties to the agreement. Another type of provision is one which confers a power if the donee of the power considers that a certain state of affairs or conditions exists. In such a case, a court may well hold that the power can only be exercised by an honest decision that the state of affairs or condition does exist, but the honest exercise of the power will not be reviewed by the court. Another type of provision is one conferring a power that is quite unqualified. In such a case, a court may conclude that the power can legitimately be exercised in the interests of the party upon whom it is conferred and that party is to be the sole judge of where its interests lie and may exersie [sic] the power for any reason it sees fit.[9]

In the commercial context, the implication of an obligation of good faith in a contract might be seen to fly in the face of freedom in contractual relations,[10] a notion which underpins modern contract law doctrine. The notion reflects the principle that obligations must be voluntarily assumed. This is particularly so in the case of sophisticated commercial agreements. To this effect, the strict enforcement of express contractual promises has traditionally been seen as the best way to provide incentives to contracting parties to perform the obligations voluntarily and expressly consented to.

Furthermore, the High Court recognised in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* ('*Toll*') that in most Australian jurisdictions, legislation has been enacted to enable the courts to 'ameliorate in individual cases hardship caused by the strict application of legal principle to contractual relations' and that '[a]s a result, there is … every reason to adhere to [principle] in cases where such legislation does not apply, or is not invoked.'[11]

In the Victorian context, a number of examples of such legislation come to mind. Sections 32W and 32X of the *Fair Trading Act 1999* (Vic) are well-known

[9] (2008) 17 Tas R 320, 322 (Tennent J, Buchanan and Mandie AJJ).

[10] A view expressed by Kirby J in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45, 75–6, where his Honour observed that

> 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.

[11] (2004) 219 CLR 165, 183 (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ).

to impose obligations of good faith in consumer contracts.[12] Section 77(1) of the *Transfer of Land Act 1958* (Vic) requires mortgagees to exercise a power of sale under a mortgage or charge in good faith.[13] In *Bropho v Human Rights and Equal Opportunity Commission*, French J noted that a total of 154 Commonwealth statutes used the phrase 'good faith'.[14] Examples often cited at the Commonwealth level are the *Insurance Contracts Act 1984* (Cth) and the *Fair Work Act 2009* (Cth), both of which impose good faith obligations for certain classes of contracts in the insurance and employment sectors.[15]

So where then does the commercial contract fit into the good faith question? Traditionally, the commercial contract has not been a class of contracts requiring the judicial or legislative protection described in *Toll*.[16] When called upon to determine disputes arising under commercial contracts, a court's approach usually will be that major commercial entities are expected to look after their own interests, especially where they are all resourceful and experienced commercial entities able to do so. I made a similar observation in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* ('*Esso*'),[17] a decision to which I will return shortly.

That said, a review of the authorities since *Renard* reveals that contractual parties are not somehow immune to good faith obligations simply because the contracts to which they are parties are the product of extensive negotiation, and legal and financial advice. Indeed, well-respected legal advisors to large commercial players advise their clients to take into account the duty of good faith in the performance of their contractual duties. One law firm has advised its clients that they should be aware of the growing acceptance of good faith in contract law, especially if something does not 'smell right' in the performance of a contract.[18] Another has advised all parties exercising contractual powers and discretions to:

(a) act honestly and cooperatively;

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

(c) make legitimate business decisions.[19]

[12] These provisions were recently considered by Cavanough J in *Jetstar Airways Pty Ltd v Free* [2008] VSC 539 (3 December 2008). On 17 March 2010, the Commonwealth Senate passed the Trade Practices Amendment (Australian Consumer Law) Bill 2009 (Cth) which introduced new penalties for consumer/investor protection breaches, new regulatory enforcement powers and a national unfair terms regime into the *Trade Practices Act 1974* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth).

[13] Considered recently by Vickery J in *Nolan v MBF Investments Pty Ltd* [2009] V Conv R ¶54-765.

[14] (2004) 135 FCR 105, 129.

[15] *Fair Work Act 2009* (Cth) s 228; *Insurance Contracts Act 1984* (Cth) pt II.

[16] (2004) 219 CLR 165, 182–3 (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ).

[17] [2005] VSCA 228 (15 September 2005) [4].

[18] Donald Magarey and Nick Seddon, *Good Faith in Commercial Contracts — An Accepted Idea?* (1 February 2008) Blake Dawson, 23 <http://www.blakedawson.com>.

[19] Adam Wallwork, *A Requirement of Good Faith in Construction Contracts?* (August 2004) Mallesons Stephen Jaques <http://www.mallesons.com/publications/publications.htm>.

It seems that, in the commercial arena, much of the confusion arises from uncertainty as to how the obligation might arise and the various meanings and inclinations that good faith might have. In many respects, the term is a 'catch-all phrase', having different meanings in different contexts and to different people.

The more specific question for our purposes is whether any meaningful distinction can be drawn between the various commercial contract dispute outcomes that I will explore. I do not propose there is a simple answer. However, I will open with this thought: the courts have three mechanisms at their disposal in which to approach a good faith problem — implication by law, implication in fact, or purposive interpretation. In each case, is it not that the court is called upon to determine the commercial purpose of the contract? If so, could 'commercial purpose' include notions of 'business efficacy', 'obviousness' and policy considerations? Is the end point not the same?

To give some context to these queries, some statements about the nature of the duty are helpful. Briefly stated, the standard of conduct required by good faith obligations has been described to include reasonableness in the broad sense,[20] a duty to act reasonably in the performance and enforcement of a contract,[21] and as requiring a party 'not to act capriciously',[22] that is to say, requiring a party to act for a proper purpose. *Carter on Contract* states the content of the duty in this way:

> the requirement of good faith might be expressed in terms that the party subject to the requirement must act honestly, and that this may … require a party to: (1) have regard to the legitimate interests of the other party; and (2) to act reasonably in exercising rights conferred by the contract.[23]

An informative review of many of the foundational and subsequent authorities was set out by Dodds-Streeton J in *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd*.[24]

Generally speaking, recent decisions at first instance and by intermediate courts of appeal (particularly the New South Wales Court of Appeal) have recognised that an obligation of good faith in the performance and execution of contractual obligations and powers 'may be implied as a matter of law as a legal incident of a commercial contract.'[25] Alternatively, other decisions at first

[20] *Renard* (1992) 26 NSWLR 234, 263 (Priestley JA).

[21] *Esso* [2005] VSCA 228 (15 September 2005) [3] (Warren CJ), citing *Electronic Industries Ltd v David Jones Ltd* (1954) 91 CLR 288, 297 (Dixon CJ, McTiernan, Webb, Kitto and Taylor JJ).

[22] *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR ¶41-703, 43 014 (Finkelstein J) ('*Garry Rogers Motors*').

[23] J W Carter, LexisNexis, *Carter on Contract* (at 14 July 2010) [01-180] ('*Carter on Contract*').

[24] [2006] VSC 223 (21 June 2006).

[25] *Vodafone* [2004] NSWCA 15 (20 February 2004) [189] (Giles JA). See also *Burger King* (2001) 69 NSWLR 558; *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 17 (31 January 2002); *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91; *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151; *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 (18 August 2000); *Garry Rogers Motors* (1999) ATPR ¶41-703.

instance, and by the Victorian Court of Appeal, have approached the issue as one of implication in fact.[26]

There are few instances in which the duty has been found to be breached. When a breach has been found to occur, it is in circumstances where a party might be seeking to prevent the performance or withhold the benefits of a contract,[27] or seeking to further an ulterior purpose, or a purpose extraneous to that for which a right or power is conferred.[28] In many instances, the courts have recognised the foregoing in principle but have shied away from involving themselves in contractual performance in this way. In *Esso*, I observed that 'courts have, more often than not, decided these matters on other bases and thereby avoided the conceptual difficulty that can attend the concept of a duty of good faith.'[29]

However, despite what may be revealed by a casual observation, good faith is a very relevant consideration to parties to a commercial contract. I hope to explore some of the reasons why this is so. Might I make the following suggestion? Underlying most contractual principles is a concern to promote good faith, and despite the underpinning of freedom in contractual relations, there is a chief concern on the part of all concerned that parties to a contract must act in good faith, and that it is in seeking to hold another contracting party to an obligation of good faith that certainty in contractual performance might be sought. Sir Anthony Mason similarly asked, 'why is emphasis on the need for good faith and fair dealing not likely to lead to the resolution of business disputes?'[30]

To consider this question, it must be acknowledged that good faith as a doctrine does not exist independently of the rules surrounding the construction and interpretation of contracts, or the rules of implication. Whilst the process of contractual interpretation is distinct from the process of implying terms into a contract, it can sometimes be difficult to separate the two. This is particularly so with regard to good faith, which appears to be obscured by what may be a merging of the two processes (interpretation and implication) in the arena of good faith.

[26] In *Esso* [2005] VSCA 228 (15 September 2005) [25] (citations omitted), Buchanan JA, with whom Osborn AJA and I agreed, noted that ad hoc implication is appropriate in Victoria where one party's vulnerability to exploitation by another's conduct exists:

> I am reluctant to conclude that commercial contracts are a class of contracts carrying an implied term of good faith as a legal incident, so that an obligation of good faith applies indiscriminately to all the rights and power conferred by a commercial contract. It may, however, be appropriate in a particular case to import such an obligation to protect a vulnerable party from exploitive conduct which subverts the original purpose for which the contract was made. Implication in this fashion is perhaps ad hoc implication meeting the tests laid down in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*, rather than implication as a matter of law creating a legal incident of contracts of a certain type.

[27] See, eg, *Metropolitan Life Insurance Co v RJR Nabisco Inc*, 716 F Supp 1504, 1517 (Walker J) (SD NY, 1989).

[28] See, eg, *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 (18 August 2000) [120] (Byrne J); *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349, 368 (Sheller JA).

[29] [2005] VSCA 228 (15 September 2005) [2].

[30] A F Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66, 89, taking up a point made by Kelly J in *Gateway Realty Ltd v Arton Holdings Ltd [No 3]* (1991) 106 NSR (2d) 180, 198.

II The Modern Approach to Interpreting Commercial Contracts: Questions of Construction and Implication

It has been suggested by some that good faith adds little to the recognised duty to cooperate,[31] famously articulated by Griffith CJ in *Butt v M'Donald*[32] and affirmed by the High Court in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd*.[33] Whatever the weight of that argument, a particular shift from the strict construction of commercial contracts to a more purposive construction can be observed. In *Toll*, the High Court stated that

> [t]he meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction.[34]

In the 2008 case of *International Air Transport Association v Ansett Australia Holdings Ltd* ('*IATA*'), Gleeson CJ spoke of the concept of 'commercial purpose' that underlies the commercial contract.[35] His Honour found that

> [i]n giving a commercial contract a businesslike interpretation, it is necessary to consider the language used by the parties, the circumstances addressed by the contract, and the objects which it is intended to secure.[36]

His Honour went on to find that

> [a]n appreciation of the commercial purpose of a contract calls for an understanding of the genesis of the transaction, the background, and the market. This is a case in which the Court's general understanding of background and purpose is supplemented by specific information as to the genesis of the transaction. The Agreement has a history; and that history is part of the context in which the contract takes its meaning.[37]

As noted by one commentator:

> The commercial purpose test has been adopted to enable the language used by the parties to be construed against the background of facts mutually known to

[31] See the general discussion in Geoffrey Kuehne, 'Implied Obligations of Good Faith and Reasonableness in the Performance of Contracts: Old Wine in New Bottles?' (2006) 33 *University of Western Australia Law Review* 63.

[32] (1896) 7 QLJ 68, 70–1: 'a general rule [applies] to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract'.

[33] (1979) 144 CLR 596.

[34] (2004) 219 CLR 165, 179 (Gleeson CJ, Gummow, Hayne, Heydon and Callinan JJ) (citations omitted).

[35] (2008) 234 CLR 151, 160.

[36] Ibid.

[37] Ibid (citations omitted); see also *Toll* (2004) 219 CLR 165, 179, in which Gleeson CJ, Gummow, Hayne, Heydon and Callinan JJ affirmed the need to take into account surrounding circumstances.

> the parties and which were influential in their choice of the language by which their rights and liabilities are to be adjudged.[38]

Turning our minds briefly to the law of implied terms, it is familiar law that the test for ad hoc implication (or implication in fact) consists of the five conditions established in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*.[39] We know the test is stringent: the implied term must be 'reasonable and equitable'; 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'; it must also be so obvious as to go without saying; it must be 'capable of clear expression'; and finally, it must 'not contradict any express term'.[40]

A term will be implied in law in circumstances where the implication of a particular term (usually an obligation) is necessary to prevent the enjoyment of the rights conferred by the contract from being 'rendered nugatory, worthless or, perhaps, [being] seriously undermined'.[41] The requirement for implying a new term in law, adopted by the High Court in cases such as *Breen v Williams*,[42] is that the new term must be necessary for the reasonable or effective operation of the contract, for the type of contract before the court, taking into account the policy considerations relevant to that type of contract. Once a term is implied in law, it becomes the law for that class of contract.

It has been suggested that the distinction between implication in fact and by law has not been universally accepted and that there may be a degree of overlap between the two methods.[43] Similar comments were made by Gaudron and McHugh JJ in *Breen* to the effect that '[t]he distinction between terms implied by law and terms implied in fact can tend in practice to "merge imperceptibly into each other"'.[44]

An overlap between implication and interpretation has also been recognised from time to time. In *Byrne v Australian Airlines Ltd*, McHugh and Gummow JJ found that:

> the more modern and better view is that these rules of construction are not rules of law so much as terms implied, in the sense of attributed to the contractual intent of the parties, unless the contrary appears on a proper construction of their bargain. There is force in the suggestion that what now would be classified as terms implied by law in particular classes of case had their origin as implications based on the intention of the parties, but thereafter became so much a part

38 F M Douglas, 'Modern Approaches to the Construction and Interpretation of Contracts' (2009) 32 *Australian Bar Review* 158, 164.

39 (1977) 180 CLR 266.

40 Ibid 283 (Lord Simon of Glaisdale for Viscount Dilhorne, Lords Simon of Glaisdale and Keith of Kinkel).

41 *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 450 (McHugh and Gummow JJ), citing Glanville Williams, 'Language and the Law — IV' (1945) 61 *Law Quarterly Review* 384, 401.

42 (1996) 186 CLR 71 ('*Breen*').

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

44 (1996) 186 CLR 71, 103.

> of the common understanding as to be imported into all transactions of the particular description.[45]

So where then does the line lie between interpretation and implication? The authors of *Cheshire and Fifoot's Law of Contract* maintain that '[i]t is often difficult to draw a line between interpreting express terms and implying unexpressed terms'.[46] It seems that this observation, as will become apparent, is particularly apt with regard to the good faith question. The border between actual and implied terms can never be precise, in that the actual terms of a contract comprise not only the terms expressed by the parties, but also 'unexpressed terms to which [their] assent can be inferred.'[47]

The distinction between the principles of construction of commercial contracts, as established in *Toll* and *IATA*, and the implication of terms was recently considered by the New South Wales Court of Appeal in *Gordon & Gotch Australia Pty Ltd v Horwitz Publications Pty Ltd* ('*Gordon & Gotch*').[48] Briefly, the facts of the case were as follows. Gordon & Gotch distributed publications on behalf of Horwitz. Pursuant to a distribution agreement between the parties, Gordon & Gotch was entitled to a returns credit for publications 'claimed' by newsagent outlets to have been unsold. The agreement was silent on the question of whether the publications had to be returned and counted. A dispute arose between the parties as to whether, on the proper construction of the agreement, unsold publications needed, in fact, to be returned and counted. It had been the practice of Gordon & Gotch, under a prior agreement, to physically count the publications returned, excluding those from more remote areas. Throughout the term of the agreement, Gordon & Gotch changed its practice so as to rely solely on claim forms returned by newsagencies, subject to auditing.

The arbitrator appointed under the agreement made the determination that 'on its proper construction … the Distribution Agreement permitted Gordon & Gotch to a Returns Credit only in respect of those publications … which Gordon & Gotch had confirmed by count that the returned [sic] had actually occurred.'[49] The Court found that the arbitrator sought to 'give content to the words of the written agreement by reference, primarily, to the text, structure and evident aims and commercial purposes of the document.'[50] The term 'claim' was therefore construed to mean 'physically returned and collected'. In rejecting Gordon & Gotch's argument that the arbitrator's determination involved impermissible implication rather than interpretation, the Court made the following statement:

> That interpretation can shade into implication and, indeed, that both may perhaps be seen as part of the one process of the construction of words in a document to identify linguistic and legal meaning can be accepted. However, the

[45] (1995) 185 CLR 410, 449 (citations omitted).
[46] Seddon and Ellinghaus, above n 6, [10.40].
[47] Ibid.
[48] [2008] NSWCA 257 (17 October 2008).
[49] Ibid [9] (Allsop P and Sackville AJA).
[50] Ibid [32].

> distinction between interpretation and implication of terms is recognised (even if the limits of each are not capable of clear definition).[51]

The Court applied broad interpretative powers in its approach to construing the contract and, on one possible view, it might be said that the decision dresses 'implication' up as 'interpretation'. On the other hand, it might simply be said that the Court applied the 'commercial purpose' test.

To place these principles in the good faith context, in *Renard*, Priestley and Handley JJA implied a term of good faith in fact or in law.[52] Priestley JA called this implication a 'hybrid between the two'.[53] Meagher JA, on the other hand, proceeded on the basis that the contract required the principal to act on accurate information when forming a view on whether the contractor had shown cause.[54] Almost 10 years later in *Burger King*, it will be recalled, a franchisee was required to develop a certain number of new franchise restaurants each year, subject to the franchisor's approval.[55] The franchisor refused to give the approval needed for the franchisee to comply with this requirement. The franchise agreement specified three types of approval as necessary conditions for the franchisor to allow further development. The agreement gave the franchisor the 'sole discretion' in deciding whether or not to grant these approvals, and outlined the factors relevant to them.

The New South Wales Court of Appeal considered that the franchisor's discretion in relation to the approvals was subject to an implied duty of good faith in law, which precluded the franchisor from exercising its discretion for a purpose extraneous to the contract.[56] The Court considered that the franchisor's refusal to give the approvals was not in fact based on the specified factors, and that the franchisor's refusal was directed to preventing the franchisee from performing its obligations under the agreement.[57] Special leave to appeal to the High Court was granted but the case did not proceed to hearing, presumably because it was settled.

Conversely, there are recent examples of cases which consider whether a duty of good faith is appropriate on the facts of the case and in light of the terms of the contract. In *Council of the City of Sydney v Goldspar Australia Pty Ltd*, Gyles J decided that '[t]he best way for a single judge to travel through this thicket is to concentrate upon the particular contractual provision in question, in the particular contract, in the particular circumstances of the case.'[58] Bergin J

51 Ibid [36], citing *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337, 345 (Mason J).
52 (1992) 26 NSWLR 234, 263 (Priestley JA), 279–80 (Handley JA).
53 *Renard* (1992) 26 NSWLR 234, 263.
54 Ibid 276.
55 (2001) 69 NSWLR 558.
56 Ibid 573 (Sheller, Beazley and Stein JJA).
57 Ibid.
58 (2006) 230 ALR 437, 499.

applied the same approach in *Australian Hotels Association (NSW) v TAB Ltd*[59] and *Maitland Main Collieries Pty Ltd v Xstrata Mt Owen Pty Ltd* ('*Maitland*').[60]

These examples shed light on the question I posed at the outset, that is, whether any meaningful distinction may be drawn between these various good faith outcomes, or between *Burger King* on the one hand and *Gordon & Gotch* on the other.

III Ad Hoc Implication and Construction of the Contract

In Victoria, whilst ad hoc implication remains a possibility in the right circumstances,[61] the good faith question is also capable of being a question of construction of a commercial contract. In fact, processes adopted to construe the terms of a commercial contract have encompassed both notions expressed by the parties as well as good faith notions found by implication to apply in other contexts.

In 2009 Pagone J delivered judgment in *Network Ltd v Speck* ('*Network*').[62] Simply put, the parties agreed in a Memorandum of Understanding ('MOU') to negotiate and enter into certain sale of business agreements, subject to the undertaking of final due diligence by the plaintiff. A deposit of $250 000 paid by the plaintiff was subject to the due diligence undertaking, and the MOU expressly provided for the expiry and termination of the agreement in certain circumstances. The MOU also provided that the defendant was obliged to repay the deposit to the plaintiff immediately after expiry or termination of the MOU, subject to the defendant complying with its obligations under the MOU. A further clause permitted the plaintiff, but not the defendant, to terminate the agreement if it had provided notice of becoming aware of a material adverse effect (as defined by the MOU) in the due diligence process.

The plaintiff gave notice under this clause, in which it claimed that the final due diligence had revealed a material adverse effect. The defendants contended that the notification was invalid because it was not given in good faith but, rather, for the collateral purpose of either obtaining a further indulgence within which to secure funding to complete the purchase, or to re-negotiate the terms of the sale otherwise agreed to by the MOU.

The plaintiff submitted that an obligation of good faith may only be found to apply to a commercial contract as a matter of ad hoc implication, and that the obligation of good faith does not apply to all of the rights and powers conferred by a commercial contract. Specifically, the plaintiff contended that the power to determine that there was a material adverse effect in this case was wholly for the benefit of the plaintiff and capable of being exercised by it without qualification, thereby excluding the implication of good faith in that regard.

In rejecting that submission, Pagone J found that such a construction of the MOU gave 'no weight to the careful balancing of rights and obligations between

[59] [2006] NSWSC 293 (19 April 2006).
[60] [2006] NSWSC 1235 (23 November 2006).
[61] *Esso* [2005] VSCA 228 (15 September 2005).
[62] [2009] VSC 235 (17 June 2009).

the parties in the MOU' that permitted a notice to be given.[63] His Honour held that because the definition of 'material adverse effect' required the plaintiff to act reasonably, then '[a]t the very least there was imposed upon Network an obligation to act in its own interest by reference to a standard of reasonableness.'[64]

Pagone J found that this obligation included good faith in the wider sense, which was not something that required implication, but '[arose] from the language of the provisions themselves', specifically, from the obligation on the plaintiff to act reasonably.[65] He held that whether implied or not, the duty would be the same, requiring an objective standard of reasonableness from the plaintiff when acting in its own interest. An express obligation of reasonableness was seen by his Honour to include good faith obligations of loyalty to the agreement, a duty not to act capriciously, and reasonableness in the promotion of legitimate interest.[66] These obligations were not expressly agreed to by the parties, but by virtue of an express obligation to act reasonably, the obligation grew to encompass wider good faith obligations.

Bergin J, of the New South Wales Supreme Court, adopted a similar approach in *Maitland*.[67] In that case, the plaintiff sought a declaration that an implied obligation to act reasonably and in good faith in the performance of the defendant's obligations applied to a Deed executed between itself and the defendant. Despite finding that commercial contracts were not a class of contracts that have an implied obligation of good faith, Bergin J considered each clause of the Deed individually as a matter of construction of the contract, in the same way as Pagone J balanced the competing rights and interests of the parties in *Network*. Three separate clauses were relevant to the plaintiff's application. First, an express term stating that the defendant would not act unreasonably when the plaintiff sought its consent to access its land pursuant to the terms of the Deed. Secondly, an obligation on the defendant to abide by the conditions set by certain named instrumentalities. Thirdly, an indemnity clause in favour of the plaintiff which required the cooperation of the plaintiff and defendant to identify the causes of damage to property contemplated by the Deed.

With regard to the first clause, Bergin J found that as there was an express term that the defendant would not act unreasonably, an additional implied obligation of good faith was unwarranted.[68] However, with regard to the second and third clauses, her Honour was satisfied that it would be 'necessary for the defendant to act reasonably and in good faith for the plaintiff to have the benefit of the Deed.'[69] The defendant was obliged to act reasonably and in good faith in ensuring the plaintiff had the benefit of the promise that the defendant and its contractors and/or agents would abide by any conditions imposed, and the parties

63 Ibid [17].
64 Ibid [19].
65 Ibid [21].
66 Ibid. Pagone J cited *Garry Rogers Motors* (1999) ATPR ¶41-703, 43 014 (Finkelstein J), which involved implied terms and the duty of good faith in the context of a termination clause.
67 [2006] NSWSC 1235 (23 November 2006).
68 Ibid [56].
69 Ibid [57].

were required to cooperate with each other to ensure that the plaintiff obtained the benefit of the indemnity.[70]

In both *Network* and *Maitland*, it appears that construing the express terms of the contract to find that good faith obligations apply was informed by the kind of obligations that have been found to apply by implication in fact and by law. Thus, it may be that interpretation, to some degree, shades into implication. The term 'reasonable' extended to include broader notions of good faith where necessary in *Network*, and express terms requiring cooperation impliedly required execution in good faith in *Maitland*.

Considering this position, we are reminded of *Renard*, in which Priestley JA spoke of the difficulties of ad hoc implication in the good faith context, and found that it is difficult to show that a term that the parties perform in good faith is 'necessary to give business efficacy to the contract' or 'so obvious that "it goes without saying"',[71] since the contract may still 'work' if the parties perform their obligations in their own interests.[72] It appears, however, that the approaches adopted by Pagone J and Bergin J indirectly find their source also in the duty to cooperate established in *Butt v M'Donald*.[73]

Placing these questions to the side, it is apparent that the approach adopted in *Network* aligns with the Victorian Court of Appeal's decision in *Esso*. In that case, I observed that '[i]f good faith is not readily capable of definition then [contractual] certainty is undermined', and that the duty to act reasonably may properly be subsumed within the duty of good faith.[74]

IV Express Exclusion and Termination for Convenience

Parties may seek to 'contract out' of the obligation. In *Vodafone*, the New South Wales Court of Appeal considered the enforceability of a contract that granted Vodafone a power to set the sales levels for its distributor, Mobile Innovations. The power was expressed to be 'in the sole discretion' of Vodafone. The contract also provided that: 'To the full extent permitted by Law and other than as expressly set out in this Agreement the parties exclude all implied terms'.[75] The Court held that each of these provisions was sufficient to exclude the implication of a duty of good faith.

This view is to be contrasted with the comments of Finn J in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* in which he considered the law to be that 'an "entire agreement" clause does not preclude implications ad hoc'; his Honour found 'the suggestion that an entire agreement clause is of itself sufficient to constitute an "express exclusion" of an implied duty of good faith' to be 'arresting'.[76]

70 Ibid [57]–[59].
71 (1992) 26 NSWLR 234, 256.
72 Ibid 258.
73 (1896) 7 QLJ 68.
74 *Esso* [2005] VSCA 228 (15 September 2005) [3].
75 *Vodafone* [2004] NSWCA 15 (20 February 2004) [95] (Sheller, Giles and Ipp JJA).
76 (2003) 128 FCR 1, 209.

Contrasts can also be noted in the area of termination for convenience clauses. Use of a termination for convenience clause is often characterised as an act not in good faith. On the one hand, it has been held by Finkelstein J that

> [m]any relationships can only operate satisfactorily if there is mutual confidence and trust. Once that confidence and trust has broken down the position is not easily restored. It is not unconscionable to terminate a relationship where that trust and confidence has been undermined.[77]

This view is to be compared with the finding of Hansen J in *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd*[78] in which his Honour granted an injunction preventing Australian Aerospace from relying on a notice to terminate for convenience a contract between the parties relating to work in the defence industry. In particular, Hansen J had regard to the nature of the dispute at hand, Defence policy manuals, and Commonwealth government documents, which suggested that termination of a contract for convenience should be undertaken in good faith and in accordance with principles of fair dealing. His Honour found that there was 'a serious question to be tried, both as to the existence of [a term of good faith] and its breach'.[79] The approach there was to imply such an obligation in law.

V CONCLUSION

It is to be said that some contracts are more susceptible to a duty of good faith than others. The way in which that duty might come about is unclear, although it seems that courts have three mechanisms at their disposal: implication by law, implication in fact, or purposive interpretation. It may be that in some instances a hybrid of these mechanisms has been applied. Judges sitting at first instance have been prepared to consider good faith in these ways. In light of the warnings of the High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*[80] to intermediate appellate courts in particular, and to courts generally, appellate reflection on good faith may be constrained. We might only reflect that it was a pity, in a jurisprudential sense, that *Burger King* and *Vodafone* did not proceed to hearing before the High Court. That said, in all our dealings, the commercial purpose test should be a fundamental consideration. On this, there is a clear mandate from the High Court. Respect for it will, in most cases, lead to the most appropriate good faith outcome achievable in any particular case.

77 *Garry Rogers Motors* (1999) ATPR ¶41-703, 43 016.
78 [2007] VSC 200 (15 June 2007).
79 Ibid [61].
80 (2007) 230 CLR 89.