WILL GOOD FAITH FALTER IN THE HIGH COURT?

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Preface

The pressure exerted by some Judges, and a number of academics, to provide relief in respect of the exercise of contractual discretions and powers by implying an obligation of good faith has persisted over the past 15 years. It has yet to be considered by the High Court, where it is argued that it is doubtful it will prevail as an obligation imputed into commercial contracts. The purpose of this paper is to identify terms implied by the common law which, at least in part, address similar evils to that which an obligation of good faith is said to be necessary to combat, and to explain why they are likely to be preferred by the High Court.

It is necessary to acknowledge the assistance derived from the work done by Dr Peden in her numerous publications[1], by Adrian Baron in a paper published in 2002[2], and writings by Professor Duncan[3] and Professor Lűcke[4]. There are even more writings than this which provided assistance in the identification of authorities and issues[5]. Amongst these is the work by Professors Stephen J Burton and Eric G Andersen, Contractual Good Faith[6] which provides an insight into the development of the obligation of good faith in the U.S.A.

Introduction

A demand for good faith, referred at times as 'bona fides', by parties to contracts was a fundamental principle in Roman Law[7]. Its legacy is found today in the European legal systems, the United States, Japan and China, but merely in name as the meaning and application varies considerably between each jurisdiction, and even within a jurisdiction[8].

In the 18th Century the obligation was accepted at common law as much as it was in equity. Lord Mansfield referred to good faith as 'the governing principle ... applicable to all contracts and dealings' in 1776[9]. His remarks, though broader, were in the context of an insurance contract, and in that respect, are accepted as authoritative to this day[10]. At common law the requirement for good faith in insurance contracts was not limited to the requirement of full disclosure of material facts but was imposed on both insurer and insured alike, and thereby applied to an insurer exercising rights under the insurance policy, such as a right to avoid[11]. This breadth of

application has been accepted and implemented legislatively in Australia, where separate duties of disclosure and good faith are imposed[12].

Lord Mansfield did not limit his observations as to the duty of good faith to insurance contracts. He saw it as a duty applicable to all contracts. As the common law developed in England and Australia, a distinction was drawn between contracts at large and those which demanded voluntary and positive disclosure of any factor which might be reasonably regarded as material in determining whether or not to undertake the contract. Such were guarantees, partnership agreements and insurance contracts. In these was implied the obligation 'of the utmost good faith' : uberrimae fides. Ignoring Lord Mansfield's more general statement of principle, over the next 200 years in the UK and Australia no implication of a duty of good faith was drawn in respect of contracts lacking those characteristics. The historical reasons for this distinction need not now concern us[13]. However, obligations of good faith have come to be imposed by legislation in Australia[14] and other common law countries[15], in respect of specific contracts, usually where the disparity in bargaining power is thought to warrant it.

Good Faith in the U.S.A.

American common law has its roots in 18th century English law, and has been influenced by European civil law jurisprudence. The implied obligation of good faith is said to have first emerged, however, at the turn of the 20th century in scattered cases, mostly in New York. The principle was expounded in the opinion of Cardozo J in *Wood v Lucy, Lady Duff-Cordon*[16]. It became a general principle of contract law after the New York Court of Appeal opinion in *Kirke La Shelle Co v Paul Armstrong Co*[17]. Outside of New York few jurisdictions developed significant law on the matter until mid-20th century[18]. The implication of an obligation of good faith is the subject of an express term in the *Uniform Commercial Code* and s.205 of the *Restatement of Contracts, Second*, promulgated in 1981. The obligation gained importance since then, even though the courts today apply it as a principle of common law. Before 1980, there were, perhaps, 350 cases; in the 12 years after there were 600 or more; since then many more. The obligation requires each party to observe good faith and fair dealing in the formation, performance and enforcement of contracts. It applies where the agreement allows flexibility to one of the parties, and is dependent upon whether, in light of the purposes of conduct, the reasons for action by the party are permissible.

In its early development the implied obligation had as its objective and purpose the securing of the fruits of the contract. In *Kirke La Shelle* the New York Court of Appeal explained the rationale:

> In every contract is there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing[19].

It has recently been described by Justice Souter in these terms:

> The concept of good faith in performance addresses the particular problem raised by a promise subject to such a degree of discretion that its practical benefit could seemingly be withheld[20].

The obligation of good faith does not demand that a party have regard to the interest of the other, but having by the contract foregone opportunities, a party is denied the use of contractual powers and discretions to recover them[21]. The court addresses the issue by examining the reasons why the contract was performed, not so much motivation of but the justification for the action[22]. The distinction between motive and justification is difficult to discern at times.

In Australia the obligation is often directed at the exercise of a power of termination, but the American cases canvass much more than that. For example, three cases were brought by a lessor in respect of the lease of a shop in which rentals were determined as a proportion of gross receipts. In one case the tenant had reduced the gross receipts and thus the rent by opening a second shop in the same centre at a flat rental, diminishing the gross revenue of the first shop. It was held that was not a breach of the obligation because the tenant was free to engage in expanding its business[23]. In the second case, the tenant opened more stores close by and so diminished the gross revenue of the first. That was held to be a normal commercial practice and not a breach[24]. But in the third case, the tenant diverted customers to another of its stores for the 'sole purpose' (so the court determined) of reducing gross receipts. That was a breach of the obligation of good faith[25].

The American courts generally agree that good faith means the absence of bad faith within the context of the agreement. Judge Scalia said the substance of good faith was derived from the expectations of the parties as expressed in the agreement itself, and so the scope of what was meant by good faith would change from agreement to agreement and party to party. The concept honoured the 'reasonable expectations created by the autonomous expressions of the contracting parties'[26].

Judicial disagreement has arisen thereafter as to how the reasonable expectations of parties should be determined. One group of jurists, known as the 'neoformalists', approach the matter in as demonstrated in some decisions in 1990 arising out of a bank refusing further advances, the customer then defaulting and declared bankrupt. The bankruptcy judge held the bank would have been secure in making a further advance, that the denial was at an inopportune time, and there was therefore a breach of good faith to refuse the advance.[27]

An appeal was successful. Judge Easterbrook said the bank had authority to deny credit and it mattered not that others may not have done so in those circumstances. There was no need to inquire into the relationship between bank and customer, nor as to the extent to which the borrower's expectations had been raised. The bank was entitled to enforce the agreement to the letter "even to the great discomfort of their trading partners, "without being mulcted" for lack of

'good faith'"; the obligation of good faith was "not an invitation to the court to decide whether one party ought to have exercised privileges expressly reserved in the document"[28]

In a later case, the same judge described the obligation of good faith as a 'gap filler', not a means to block contractual powers and discretions[29].

This lead was followed by Judge Richard Arnold, on the Eighth Circuit, who observed that the "law did not allow the implied covenant of good faith and fair dealing to be an ever flowing cornucopia of wished for legal dictum"[30].

Then, in 2001, it was held that the obligation did not require parties generally to act reasonably; nor was it a restriction on a discretionary authority: it merely provided a method of dealing with circumstances not contemplated when the contract was made[31]. This is contrary to the development in Australia by those jurists favouring the implied obligation, though consistent, as will be seen, with others.

Contrary to this, the Tenth Circuit courts took a more expansive view, being concerned to protect 'reasonable expectations' by examining whether a party employed the contractual discretions and powers in accord with those expectations. The actions 'must be consistent with the agreed common purpose and the justified expectations of the other party', and the 'purposes, intentions and expectations of the parties should be determined by considering the contract language and the course of dealings between and conduct of the parties'[32] This permitted an inquiry into the language, the course of dealing, trade practices and conduct of the parties. As will be seen, it is this approach which has found favour with those Australian jurists who seek to introduce the implied obligation into Australian common law.[33]

The neoformist approach is proving more popular at present. Professor Howard Hunter has explained[34]:

> The growing reluctance of some courts to look behind the explicit language of an agreement to determine whether the conduct of the parties has been consistent with the reasonable expectations and the goals of the agreement reflects the general rise of neoformalism. The hallmark of this return to some of the approaches of contracts scholars of the late 19th-century is reliance upon the 'plain meaning' of an agreement, which, if all formal requisites are met, used to be enforced according to its letter. To the extent that strict enforcement creates results that are surprising to a party in the context of what had been thought to be mutual expectations, the cure is to be found in the marketplace, not in the interpretation of the agreement by court. This approach always has had attractions when the parties have engaged in serious line by line negotiations and are similarly situated. It has not been as widely accepted when there has been less negotiation – especially about the terms at issue – or when the parties are not similarly situated and when the contract at issue is the essentially a form agreement. The neoformalists reduce the public role of contract law as an ordering mechanism and turn it

> into a rule-based matrix that leaves ordering to the marketplace. They also turn upside down the substantial – some would argue radical – shifts in emphasis of the *Uniform Commercial Code* and of the *Restatement 2d of Contracts*.

There is, as far as can be seen, little or no recognition in Australian cases of this debate, nor any recognition of the current trend in America. It is a trend which would disappoint some jurists in Australia, for it is the other approach that they assume and extol in their judgments.

Good Faith in Canada & New Zealand

To the extent that Canada has followed the American lead in implying a duty of good faith, it has been the neoformist school that it has preferred. In 2003 the majority in the Ontario Court of Appeal[35] declared that the Canadian Courts had not recognised a 'stand alone' duty of good faith independent of terms expressed in the contract. A duty of good faith could not create un-bargained rights and obligations, nor could it be used to alter the express terms of a contract. The third Judge[36] dissented on the ground that the relationship between the parties was not such as to warrant an implied duty of good faith, but in any event the terms of the contract precluded it[37].

In New Zealand the Court of Appeal has rejected the implication of an obligation of good faith when determining a dispute arising out of a tender agreement.[38] It accepted there was a duty to treat the parties tendering in an even-handed manner, but declined to characterise that as a duty of good faith and such additional demands as that would invoke. The decision implicitly rejected the principle that an obligation of good faith is to be implied in all contracts[39].

Position in the UK

The UK has not accepted an implied duty of good faith since the foray of Lord Mansfield, except where there is a specific relationship between parties that gives rise to it, as between insurer and insured, and like cases.

The implication of contractual terms has undergone several stages of development in the common law. During the 19th century terms were implied in accordance with the parties intentions, as discerned by reference to the express terms of the contract[40]. Since the ascertainment of the parties intention became a fiction, and since it was more likely than not that the parties had not turned their minds to the matter in issue, this led to the implication of terms necessary for 'business efficacy'[41]. That was refined to limit the implication to terms to those that were 'necessary', as distinct from 'reasonable'[42]. Another mode of expression is that a term is implied only where, had they been alerted to the issue, both parties would have said it was obvious what should be done[43]. The requirement of necessity, not reasonableness, was emphasised by Lord Wilberforce in 1977 in *Liverpool City Council v Irwin*[44], which has remained the principle authority in the UK since that time[45]. Although some judges prefer 'business efficacy', others 'necessity', yet others 'obviousness', the result tends to be the same[46]. This is referred to as the "*Irwin* test".

The *Irwin* test has proved effective in its protection of contractual benefits and so achieving the objectives which, today, the proponents of an obligation of good faith pursue. This has been achieved by enforcing cooperation between the parties, being an obligation implied in consequence of a line of authority commencing with *Mackay v Dick*[47]. Thus:

- an implied term that a party not of its own motion put an end to the continuance of an existing state of affairs necessary for performance of the contract[48];
- an implied term not to prevent fulfilment of a condition precedent[49];
- an implied term not to rely on a party's own breach to draw a contractual benefit[50];
- an implied term that a party will not prevent the other from performing the contract[51];
- the doctrine of promissory estoppel[52];
- the rule in equity providing relief against forfeiture[53];
- an implied obligation to exercise due diligence or best endeavours to obtain a consent, approval or licence where such consent, approval or licence from a third party is essential to the performance of the contract[54];
- the invalidation of penalty clauses[55];
- an implied term that a contractual discretion or power will not be exercised dishonestly, capriciously or arbitrarily[56]; and
- an appropriate term implied as a legal incident to express terms, not being the presumed intention of the parties[57], where that be "reasonable"[58] and "of necessity"[59]. The term must satisfy both tests, it not being sufficient for it merely to be reasonable[60].

This is not to say that the development of the common law in England manifested a broad principle of good faith, though it is possible, as many do, to give those words sufficient breadth of meaning to embrace all of those implications. Indeed, if honesty is seen as the hallmark of 'good faith' (as it does in other areas of the law), then one can argue persuasively that each of these implications and forms of relief have as their purpose the enforcement of honesty in the performance of contracts.

This argument was put to the Ontario Law Reform Commission in 1983[61] and answered[62] in these terms:

> If it served a useful purpose, it would be the easiest thing in the world to select a number of post-war cases in Anglo-Canadian contract law to show that our law is shot through

> with the ethic of good faith. Assuming that the impressionistic picture conjured up by the idea of good faith and fair dealing were left untainted by analytical method, who could possibly deny the immanence of good faith and who could resist attempts to stitch these various case law developments into an ethical backcloth setting off modern Anglo Canadian contract law? But this in itself would not justify attempts to transform moral postulates into the language of legal rules; still less would justify a radical suppression of large parts of the rule structure of our contract law[63].

It would be wrong to assume that the moral imperative of honest performance of contracts (and so good faith) has led to the development of these principles. Lord Actner said that "the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations" and "unworkable in practice"[64]. Similarly Potter LJ observed in denying relevance to an injured party's motive in termination of a contract, that "there is no general doctrine of good faith in the English law of contract. The [injured parties] are free to act as they wish, provided that they do not act in breach of the terms the contract"[65]. Nor does English law distinguish in general between deliberate breaches of contract (bad faith) and innocent breaches: "a deliberate contract breaker is guilty of no more than breach of contract"[66]. Consequently 'dishonesty' in performance is immaterial (but, of course, dishonesty in the form of misrepresentations in the formation of a contract is material).

The imposition of an obligation of good faith has been described as a departure in principle from the traditional process of development of common law. Lord Hope contrasted differing systems of jurisprudence, one being reflected in a Scottish decision where a broad principle of fair dealing in good faith was established, and by its application the particular case determined; the other being English jurisprudence which 'favoured piecemeal solutions in response to demonstrated problems of unfairness'[67]. Lord Hope had in mind, no doubt, what Bingham LJ said in 1989, and again in 2002:

> ... in many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms has converted, playing fair', 'coming clean' or 'putting one's cards face upwards on the table'. It is in essence the principle of fair and open dealing... English law has, characteristically, **committed itself to no such overriding principle** that has developed piecemeal solutions in response to demonstrated problems of unfairness[68].

Lord Hoffman has explained the reluctance to imply a condition of good faith on the ground that it would introduce uncertainty into contract law:

> The principle that equity will restrain the enforcement of legal rights when it would be unconscionable to insist upon them has an attractive breadth. But the reasons why the

> courts have rejected such generalisations are founded not merely upon authority... but also upon considerations of business. These are, in summary, that in many forms of transaction it is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this would be "unconscionable" is sufficient to create uncertainty[69].

There have been statutory inroads in England. The *Unfair Contract Terms Act 1977 (UK)* declares an exemption clauses ineffective in certain situations, and gives to the courts the discretion in a wide category of other cases to deny effectiveness to an extension clause unless it be fair and reasonable[70]. The *Unfair Terms in Consumer Contracts Regulations 1994 (UK)* implemented into English law of the EC Directive on *Unfair Terms in Consumer Contracts*[71]. This permits setting aside any term not individually negotiated and which contrary to the requirement of good faith causes a significant imbalance in the party's contractual rights and obligations to the detriment of the consumer[72]. The EEC has issued a directive co-ordinating the laws of Member States concerning self-employed commercial agents which demands that the agents act in good faith, and that has been adopted in English law[73]. Further EEC directives with similar requirements are likely to be adopted[74].

The impact of European concepts on English law may mean that in the years ahead an implied obligation of good faith will be accepted and implemented as a development of the common law. Impeding this are the divergences in Europe in the significance given to 'good faith' and the uses to which it is put. In some (but not in all) systems, good faith has provided the basis of some pre-contractual grounds of relief or compensation (notably, as regards the duties of disclosure and information and breaking off from negotiations); the addition of "supplementary" obligations to those expressly provided either by the parties or by the legislation; the control of unfair contract terms; the toughening of the sanction of deliberate breaches of contract; the control of the exercise of a party's contractual right; and relief on account of supervening circumstances or the substantively unfair nature of the contract as a whole[75]. In the result, the notion of good faith (or its equivalents in the various languages...) means different things *within* a particular legal system and *between* legal systems. Lord Bingham said there is "no common concept of it... good faith"[76]. In the result, the English "piece-meal" approach may be expected to prevail even if, as a general principle, an implied term of good faith is ultimately accepted.

There are similar divergences between and within jurisdictions in America. Alabama regards the requirement for good faith as merely a directive, not giving rise to a remedy[77], but in other jurisdictions it does allow a remedy. Superficially, 'good faith' is vague enough to permit a party to complain about almost anything, and until the rise of the neoformists, there was an explosion of litigation raising good faith issues and highlighted by some huge recoveries against insurers, lenders and employers. This led to an immense corpus of law with many practical implications far beyond what was first imagined[78].

English jurists are unlikely to invite this turmoil into the common law.

Position in Australia

Australian jurisprudence has followed the common law as developed in England. The implication of terms of a contract are subjected to the tests identified by the Privy Council in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*[79], namely that the implied term be reasonable and equitable, necessary for business efficacy, obvious, capable of clear expression and not contradictory of an express term (which mirror the *Irwin* test). The High Court has accepted and applied these tests[80]. It has entertained a lesser test where the contract is incomplete, in which event terms may be implied if necessary for the 'reasonable or effective operation of a contract of that nature in the circumstances of the case'[81]. These principles apply to terms "implied in fact', being based on imputed intentions of the parties. There are also terms implied by law[82]. There are also cases where the special relationship established by the contract carries with it an implied obligation of good faith[83]. For the purpose of this paper, these tests will be referred to as the *BP & Hawkin* tests.

The general principles identified by the High Court as applicable to all contracts, subject only to express terms to the contrary, have been applied in appropriate cases to imply terms where one or other of the *BP & Hawkin* tests is satisfied, the following being some examples:

- each party to a contract agrees, by implication, to do all such things as are necessary to permit the other party to have the benefit of the contract[84]. This is restricted to preserving the benefit of the contract, not otherwise benefiting a party[85]. It demands close attention to the terms of the contract and its commercial context, and does not extend to effecting that which the contract did not require[86]. Where they are commercial parties contracting at arms length, the degree of cooperation may not be significant[87]. The duty is limited to what is reasonable in the circumstances[88].

- there is sometimes implied an obligation to act reasonably in the performance and enforcement of the contract, for example in responding to reasonable requests[89]; or not to act capriciously in the exercise of a contractual discretion[90] or the exercise of a power to terminate for non-fulfilment of a contractual condition[91]; and to make 'honest endeavours' to ensure a condition precedent is fulfilled[92].

- there is an obligation not to destroy or impair the continuation of the state of things upon which the contract is made[93], and act in accord with the contractual objective[94].

The High Court has not developed these terms implied in law out of a general principle of good faith, but, as in England, has derived them from earlier precedents, particularly, English precedents. As was put to the Ontario Law Reform Commission, the assembly of such matters may readily be seen to be an array of examples of good faith, and it may be argued from such a selection that they have a common foundation, that being 'good faith', but that is not how they were developed.

Controversy has arisen as to whether there should now be implied in all contracts (or all commercial contracts) an obligation of good faith and fair dealing in performance and enforcement. It is argued that part of or additional to this obligation there should be implied a duty to exercise contractual powers and discretions reasonably.

Some contend that the implied obligation of good faith it is universal; some that it is restricted to specific classes of contracts; others that it is dependent upon satisfaction of the appropriate *BP & Hawkin* test.

Universal Obligation

The imposition of a universal obligation of good faith, if it has occurred, is a significant departure from the development of the common law relating to implied terms[95]. Sir Anthony Mason has argued that it is an inevitable outcome of the development of the common law[96]. He contended that it was implicit in the orthodox implication of terms and opined that the time was approaching in England where it would be recognised as implicit in all contracts. The same view was propounded by Steyn J in 1991, and was adopted by Priestly JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*.

It is argued by these men that the common law jurisdictions, except for England, were moving in this direction, that international conventions imposed such an obligation, that it was found in European jurisdictions and through the EU that would have an inevitable impact on the common law in England. Attention was drawn to the statutory imposition of the obligation in respect of specific contracts in Australia and England, and the power given to an arbitrator by s.22 of the *Commercial Arbitration Acts* in the various States permitting, if the parties agree, the resolution of the dispute by reference to considerations of general justice and fairness[97]. Reliance was placed on the adoption of an implied obligation of good faith in the United States, which had developed out the same common law background as that of Australia, was a highly commercial country, and that its adoption was said not to have caused significant difficulty in operation[98]. The observations of Stephen J in *Godfrey Constructions*[99] were mentioned as indicating a tendency in the High Court towards this direction, that case restraining rescission for an improper purpose; and *Pierce Bell*[100] where a vendor was restrained from acting in an unconscionable manner.

Gummow J in *Service Station Assn Ltd v Berg Bennett & Associates Pty Ltd*[101] said of this reasoning that "... it requires a leap of faith to translate these well established doctrines and remedies into a new term as to the quality of contractual performance, implied by law". Similar doubts were expressed by Kirby P in *Biotechnology Australia Pty Ltd v Pace*[102]. On the other hand, in *Hughes Aircraft Systems International v Airservices Australia*[103], Finn J considered that the "more open recognition [of an implied term of good faith] in our own contract law is now warranted", expressly departing from the view expressed by Gummow J.

For a time Finn J's view (which followed *Renard*) prevailed over that of Gummow J. In *Alcatel Australia Ltd v Scarcella*[104] the Court of Appeal held that in New South Wales there *may be* a

duty of good faith imposed in respect of performing contractual obligations and exercising contractual rights[105]. This fell short of the obligation being imposed in all contracts, as proposed by Priestly JA in *Renard*, but left it open to be implied without application of the appropriate *BP & Hawkin* tests. In *Burger King Corp v Hungry Jack's Pty Ltd* Sheller JA appeared to support its imposition into all "standard form commercial contracts"[106]; but in *Vodaphone Pacific Ltd v Mobile Innovations* Giles JA said this was not a correct understanding and that it was more limited, unfortunately not explaining what those limitations might be[107]. On the other hand, the Full Court in *Bropho v Human Rights & Equal Opportunity Commission*[108] interpreted Sheller JA as saying it did apply universally, but the Court of Appeal in *Central Exchange Ltd v Anaconda Nickel Ltd* interpreted Sheller JA as restricting it to 'commercial contracts'[109].

There has been, especially in N.S.W., reliance on *Renard* as justification for an implied obligation of good faith in numerous contracts - so numerous that it appears at nisi prius there is an acceptance that an obligation of good faith is to be found in all commercial contracts[110]. The absence of consideration of an appropriate *BP & Hawkin* test emphasises that Finkelstein J in the Federal Court accepts it is so, being (as he puts it) a preference "for the position taken in the United States over the more traditional English approach"[111]; so too Byrne J in the Victorian Supreme Court[112], with Nettle J in the same court saying "... allowing for the existence of an implied obligation of good faith and fair dealing, about which *I suppose there can no longer be too much doubt*" (but rejecting a breach in that case)[113].

As will be seen shortly, there is room for considerable doubt, if not rejection, of the proposition that such an obligation is to be imposed in all contracts, or all commercial contracts.

Generic Obligation

A different approach is to imply the obligation of good faith by identification of a particular class of contracts, rather than all contracts. The implication of specific obligations in identified classes of contracts is countenanced by the High Court[114]. Two steps are required, the first to identify the class of contract, and the second to identify the specific obligation (frequently referred to as a 'generic term').

This approach is applied more readily where the class of contract, and the appropriate generic term, has been recognised in the past. Examples are the obligation to exercise reasonable care implied by law in professional service contracts[115]; the obligation to use best efforts in distributorship agreements[116]; the obligation of confidentiality in an arbitration agreement[117].

It has been held the classes are not closed[118], albeit there is little guidance as to the criteria by which a new class might be created. It is arguable that a class must comprise contracts with common characteristics permitting the identification of an inherent obligation. The term must be *necessary* to prevent contractual rights being rendered nugatory, worthless or seriously undermined[119], a requirement the High Court has emphasised on several occasions[120].

"Necessary' may be contrasted with 'desirable' or 'helpful'. The restriction imposed by the High Court is not surprising, for if obligations may be implied for no better reason than that they are desirable or helpful, the principles espoused in the *BP & Hawkin* tests would become redundant. It would no longer be necessary to refer to business efficacy, or obviousness, and certainly not necessity. All that would be needed would be to establish the protection that the implied term would afford.

An expansion of a 'class' to encompass all contracts is surely beyond what the High Court had in mind for if that were contemplated, it would have referred to contracts in general; yet to allow the creation of new classes without identification of an appropriate criteria may well have this result, especially if the generic term is to be an obligation of good faith, fair dealing and reasonableness.

The matter was addressed in *Renard,* which concerned a contract between government and a private company in which a senior public servant was empowered to determine whether good cause had been shown to avoid termination for breach. There were characteristics which previously had been identified as creating a distinctive class. In a line of authority commencing with observations by Starke J in *Dixon v South Australian Railways Commissioner*[121] and followed by the intermediate appeal court in *Amann Aviation Pty Ltd v Commonwealth*[122], it had been decided that where a show cause process was provided, the decision-maker must act without bias, capriciousness[123] and bad faith[124]. Shepherd J explained the restraint on the ground that it was a construction contract entered into by a government agency which had no interest beyond that of the public in its performance, and in which a public servant had been empowered not only to examine whether good cause had been shown to excuse the default, but also was empowered to arbitrate any dispute.

The identification of the public nature of the contract as a characteristic of significance in the particular class of contract was again made by Finn J in *Hughes Aircraft Systems International v Airservices Australia.*[125] The case concerned a public tender. Finn J held there was an implied obligation to conduct the evaluation fairly, it being obvious, in accord with community expectations, and may be implied in respect of particular classes of contracts. He was expansive in his reasons, albeit holding that the appropriate *BP & Hawkin* test was satisfied[126]. Consequently it was unnecessary to consider whether such a term was implied in law[127]. Nonetheless, he used the opportunity to support Priestly JA in *Renard* and said the contract was of a class attracting an implied obligation. The tenders were submitted to a public body obliged to act in the public interest, which is required by law to act fairly[128]. Thus he followed the path blazed by *Dixon* and *Amann,* identifying the class as being contracts concerning a public body as a party.

In *Renard* the decision to terminate was not found to be dishonest, nor lacking in bona fides, nor not proper and due. There was no bias, it was not capricious, arbitrary or made in bad faith, at least so far as Priestly JA and Handley JA were concerned[129]. However it was not a 'just decision' because the decision maker had been denied relevant and material information[130], and

consequently was 'objectively unreasonable' and an invalid exercise of power[131]. This, it was said, required the importation of an obligation of reasonableness assessed objectively.

The contract fell within a class being that of construction contracts. Priestly JA acknowledged that the implication in law of an appropriate obligation required more than it be reasonable, and that it must be necessary as well. Necessity was satisfied if business efficacy required it, but even if that were lacking, he said it would be enough if 'current standards demanded it'[132]. He referred to *Meehan v Jones*, which he found to support an implied term requiring a purchaser to do all that was reasonable to obtain finance, which is a surprising interpretation of that decision[133]. He referred to the intermediate appellate decision in *Amann* when identifying the trend towards implying an obligation of good faith, but did not rely on it to identify a class of contract in which the *Renard* contract fell.

Handley JA acknowledged the force of *Meehan,* noting it held that honesty in exercise of the power was enough, but found that in respect of construction contracts there was a presumption that contractual discretions would be exercised only where reasonable and just. In this context he referred to the intermediate appeal court decision in *Amann,* which he relied upon to emphasise the significance of show cause provisions in supporting an implied obligation that termination would be exercised only upon reasonable grounds[134]. He said the presence of an arbitration provision gave further support as it could not be supposed that the Arbitrator would not consider whether the termination was reasonable[135]. He did not attribute significance to the public nature of the contract as had been done in *Amann*.

The reasoning by these two judges has had a significant impact on the development of the principles relating to obligations implied by law. Priestly JA did not define what he meant by a 'current standard', which necessitated, he said, the implication of an obligation of good faith, fair dealing and reasonableness. It appears from the rest of his judgment that this 'standard' may be derived from developments in the statute law, and in equity, or perhaps more general policy considerations, thus importing a new obligation[136]. It is implicit that the provisions of statute law have a more restricted application, being the conscious decision of Parliament, than what a court is by this means empowered to do - that is, to expand the statutory reach of such a provision. Likewise, the adoption of an equitable principle, developed for quite different purposes, is permitted. The identification of policy considerations was without guidance. This removes any restraint on what might be done in judging a case - the selection and application of statutory provisions, equitable principles and policy considerations being left to the judge. Gummow J has said of this[137]:

> Invocation of 'community standards' may be no more than an invention by the judicial branch of government of new heads of 'public policy, something long ago regarded as a risky enterprise: cf *Gollan v Nugent* (1988) 166 CLR 18 at 35 per Brennan J.

This process may be contrasted with the restraints imposed upon terms implied by custom, which is created by merchants over a period of time and identifies the obligations that the particular

industry regards as appropriate. It is not the same as, nor referable to, current 'standards', if by that is meant current legislative or social policies, or even to what merchants in other fields of commerce may accept as appropriate.[138] The existence of such a custom must be proved as a fact - thereby negating the use of judicial opinions which, no matter how strongly held, may be in error. It must be so well known and acquiesced in that everyone making a contract in that situation can be reasonably assumed to have imported the term into the contract[139]. It is not judge made law, but is that of the particular merchants. Thus in this instance due regard is had for the freedom of merchants to make their contracts in accordance with their expectations. This is a very different situation to that postulated by Priestly JA, whose new found principle permitted the introduction into a contract, at a time of disputation, an obligation which the Judge determines that 'current standards' demand irrespective of whether those standards were sufficiently well known to the merchants when the contract was made (or at any other time). Since a 'current standard' may embrace what otherwise would be a custom, the new principle (to that extent) avoids the restrictions the High Court imposed on terms implied by custom. Gummow J has questioned as to how these standards may be ascertained, and by and of whom, noting that in America it is seen by some as "a licence for the exercise of judicial or juror intuition, resulting in unpredictable and inconsistent applications, requiring repeated adjudication before an 'operational standard' may be 'articulated and evaluated'.[140]

There is a further consequence effected by empowering Judges to identify classes of contracts without adherence to identifiable criteria. The Courts had explained, prior to *Renard*, that there was a class of public contracts and explained why their public nature attracted an implied obligation. In *Renard* this was not done, for the identification of the class was very loose and indeterminate - is it construction contracts, or broader still, commercial contracts? - and there was no identification of the characteristic of the class that attracted the implied obligation, far less a justification. Thus in *Alcatel* where the agreement was a lease of commercial premises, Sheller JA, with whose judgment Powell JA and Beazely JA agreed, relying upon the reasoning in *Renard* and *Hughes Aircraft Systems*, said that in New South Wales there *may be* a duty of good faith imposed in respect of performing contractual obligations and exercising contractual rights[141]. Sheller JA did not say he regarded the principles espoused in the earlier cases as limited to public contracts, nor to construction contracts, though he toyed with the idea of a class of 'standard form commercial contracts'.

Later, in *Burger King Corp v Hungry Jack's Pty Ltd* Sheller JA departed from what he said in Alcatel and said the impliued obligation was not restricted to standard form contracts (whioch the contract in *Burger King* was certainly not)[142]. That was because the implied obligation was necessary in any contract which might be terminated for a minor breach which he regarded as unacceptable. That could be so in respect of any contract that contained a termination clause, so the class was thereby extended to most if not all commercial contracts[143], a very wide class. As mentioned earlier, in *VodaphonePacific Ltd v Mobile Innovations* Giles JA said this was an erroneous interpretation but did not identify the class of contract the decision in *Burger King* related[144]. Indeed, he made no attempt to identify a class in that case.

If *Vodaphone* is correct, then the result justifies an implied obligation in law not by reference to a class of contracts, but to the circumstances of a particular contract, as occurred in *Tomlin v Ford Credit Australia*[145], where the obligation was implied in consequence of the express terms of the contract. It is surprising, in that case, that the appropriate *BP & Hawkin* test was not applied, for to ignore it was to subvert those tests by the expedient of no more than describing the implication as one 'of law' rather than 'of fact'.

There have been a number of occasions in New South Wales where classes of contracts have been identified as being subject to an implied obligation of good faith and reasonableness, including a dealership agreement[146], franchise agreements[147] and a television licensing agreement[148]. In none of these cases has a class, beyond that of 'commercial contracts', been identified.

Other jurisdictions have been more cautious. An obligation of good faith has been denied by the Queensland Court of Appeal in respect of a franchise agreement[149]; left in abeyance by the Western Australian Full Court in respect of a Deed of Settlement[150]; denied by the Victorian Court of Appeal in respect of a distribution agreement[151] and in respect of contracts generally[152]; and despite enthusiastic support by Finkelstein J in several cases[153], the Full Court of the Federal Court has left the matter to be determined by the High Court[154]. These decisions suggest that the implied obligation is to be found in the terms and circumstances of each case and not by reference to a class of contracts.

If that be so, it should be done only by the application of the appropriate *BP & Hawkin* test. As said by Professor Carter and Dr Peden[155]:

> It seems obvious that because good faith is already in inherent in contract doctrines, rules and principles, if the court implies a term of good faith the court is either implying a redundant term or implying a term which, by definition, must impose a more onerous requirement. Such a term must surely be justified by reference to particular circumstances and not general principle. In other words, we do not deny that in some cases it will be appropriate to imply a term which imposes a higher standard of good faith than the law otherwise requires, but it will be necessarily have to satisfy the well established rules for implication and will be a rare phenomenon. In relation to the cases which suggest that term of good faith is implied in law, it is sufficient to say that such an implied term merely creates a default rule, and since that default rule already exists it is also an illegitimate implication.

The application of the principles relating to an implied term at law in the absence of an identifiable class of contract involves a serious departure from what the High Court has said is required.

Contract Specific

As mentioned much earlier, there is no suggestion in the authorities that the *BP & Hawkin* tests have been rejected in Australia: to the contrary, Australian authority has quite recently affirmed their application[156]. Indeed, in *Renard,* Priestly JA applied the appropriate *BP & Hawkin* test to imply an obligation to exercise the power of termination reasonably. That has been criticised, but its force need not be considered in this paper.

The successful application of the appropriate *BP & Hawkin* test does not mean that an obligation of good faith is to be implied or that a contractual discretion or power is to be qualified by reference to good faith and reasonableness. If the appropriate *BP & Hawkin* test is satisfied, the breadth of term implied or qualification imposed is determined by that necessity, that is, whatever is necessary to ensure the contract is not rendered unworkable. It is not determined by matters extraneous to that, such as 'current standards' or some indeterminate concept of what a court might think is the 'fair'. A contract is no less workable because it does not accord with a 'current standard', or operates 'unfairly'. Unless freedom to contract is to be circumscribed, parties can make contracts offending the sensibilities of others, including jurists, if they so wish, so long as they remain within the bounds of law.

Content of Good Faith

The obligation of good faith, where it is implied, has as its objective the control of the exercise of contractual discretions and powers. Consequently, it is often described as an 'incident' to the express stated terms and conditions of a contract[157]. It provides relief when established that a party exercised a contractual discretion or power 'in bad faith'.

This does not assist in determining what 'bad faith' may mean. On that there is disharmony. One approach is that the expression has no general meaning, 'but serves to exclude many heterogenous forms of bad faith'[158].

Others say it has an identifiable core meaning of loyalty to the contract[159], a restraint on self interest[160]. This is to have regard to the legitimate interests of both parties in the enjoyment of the fruits of the contract as delineated by its terms[161].

The generality of these statements warrants further comment:

- the mere duplication of objects previous established in the law does not provide a sound basis for importing a new obligation. For example, the obligation of good faith is said to explain the principle that a capricious exercise of a power is a breach of contract[162]. That had long been the law, previously explained in terms of wrongful deprivation of the commercial benefit of the contract or frustration of the commercial purpose[163]. The 'wrongfulness' may appear to be the same as bad faith, it certainly being incorporated into that concept, but as was explained by Mason CJ[164], there is a difference between carrying

out a contract *only* if it suits the party to do so and carrying it out *when* it suits the party to do so. In the first, the party repudiates the contract; in the second, repudiation depends upon whether the party evinces an intention not to be bound by or has acted inconsistently with contractual obligations. This does not involve absence of good faith or proof of bad faith, but rather inconsistency with what the contract provided. The concept of 'good faith' may be employed as the label, but no more, for it adds nothing; if such labelling does have significance, then it expands the law.

- to the extent that an obligation of good faith duplicates the long established implied duty to cooperate, the change is merely one of terminology. Both are founded on 'loyalty to the contract' and have been considered equivalents[165]. They are not identical. The duty to cooperate applies where the express terms of the contract demand cooperation, as, for example, does a term for the continuing commercial support of a franchisee by the franchisor. Good faith, on the other hand, purports to restrict the exercise of contractual discretions and powers so as not to deprive the other party of the benefits, and in so doing may look to motive or, as the Americans prefer, to justification. Each encompasses matters that may not be included in the other. If they do duplicate each other, no more is done than to change the description from "duty to cooperate" to "an obligation of good faith".

- a breach of good faith may be evidenced by unconscionable conduct[166] and these two concepts also overlap. Once again, it is only because one is more extensive than the other that it warrants pleading them cumulatively or in the alternative. The principles that have been developed in respect of unconscionable conduct gain nothing from being incorporated into or embraced by an obligation of good faith, unless it be that those principles are thereby modified or dispensed.

- in *Renard* Priestly JA relied upon the obligation of good faith to support the obligation to to act reasonably. Once again, the two concepts are different, as Priestly JA recognised in 1988[167]. The obligation implied, therefore, is often, and more properly, described as an obligation of 'good faith and reasonableness'[168]. Whilst acting reasonably may be necessary to satisfy a good faith obligation[169], satisfying good faith does not mean the conduct has been reasonable. Prior to *Renard*, there were occasions when there was implied such a restriction on the exercise of powers, but on a case by case basis following the application of the appropriate *BP & Irwin* test. The implied obligation was seen as a corollary of the duty to co-operate being implied in every contract[170].

How, then, does the implied obligation to act in good faith extend recognised principles? In determining whether it is breached, some courts have regard to the party's motive or 'intended purpose'[171]. A breach of good faith is shown by establishing an ulterior motive to inflict harm on the other party, rather than to advance the legitimate interests of the party exercising the discretion. However, good commercial reasons are sufficient to justify conduct[172]. On the other hand, bad faith is established by exhibiting bias between tenderers[173], delaying performance and

making misrepresentations[174]; calling off a contract pursuant to a deliberate plan to deny the other party entry into the industry[175]; withdrawing financial support and operational approvals to deny performance of obligations[176]. In these matters the courts have emphasised that they are not restricting decisions taken, reasonably, to promote the legitimate interests of a party[177]. The American distinction between motive and justification has not been recognised to date.

On other occasions, the courts have spoken in general terms as to what it means - terms so general as not to advance the concept. It is said good faith means 'fairness or fair dealing'[178], to eschew bad faith[179], not to act capriciously or for some extraneous purpose[180], to be loyal to the contract[181]. As one academic has said, such descriptors provide little guidance for contracting parties nor their legal advisors, all of whom need to understand how the implied obligation impacts upon them[182].

Most of these cases were amenable to the resolution in accordance with the common law as developed before the introduction of an obligation of good faith, although in some instances the reasoning based on an obligation of good faith demands a departure from what the common law allows. For example:

- at common law performance in compliance with the terms of a contract is not converted into a breach merely by reference to the intention of the party exercising the contractual discretion or power[183]. With the obligation of good faith, and its emphasis upon the purpose for which the power was in fact exercised, this principle is foregone.

- at common law there was a demand for honest but not reasonable performance[184]. The introduction of the concept of reasonableness gives much greater scope to the courts in assessing whether the conduct accords with what it thinks was reasonable.

This last matter stands out as a significant departure from the past. It is what some would describe as the arrogation of power to the jurist to determine whether a party has acted reasonably in exercising contractual discretions and powers, and so alter the balance between the parties to the contract. In America this would be criticised for upsetting "the negotiated risk allocations of the parties", even (or perhaps especially) where one party is given 'unbridled discretion'[185].

Exclusion of the Obligation

There is no authority denying that the express terms may exclude an obligation of good faith[186] and, indeed, there is authority where it has occurred[187]. An obligation of good faith imposed by statute will prevail over any written term. It would be another matter for the common law to deny to parties their right to exclude such an obligation[188].

If it were desired to make it clear that contractual discretions and powers are free of any such implied obligation, then little more would be required that to provide, expressly, that the exercise

of the discretion and power was in the 'absolute discretion' of the party upon whom it was conferred.

Reluctance of Highest Courts

The imputed obligation of good faith has yet to be endorsed by the High Court, and, indeed it has rejected it in the case of employment contracts, excluding an implied duty of "procedural regularity or fairness" restricting an employer's right to terminate.[189] The Court refrained from expressing an opinion more generally in *Royal Botanic Gardens and Domain Trust v South Sydney City Council*[190], notwithstanding that arguments were advanced[191].

Gummow J made known his opposition to such an implied obligation before elevation, providing a discourse on why such a term should not be implied, rejecting the reasoning in *Renard*[192]. Kirby J[193], before his elevation, observed that the implied obligation conflicted with fundamental notions of caveat emptor inherent in common law conceptions of economic freedom, and inconsistent with the law as developed in respect of implied terms[194]. Heydon J, before his elevation, confined the occasions for implication of a term to four only, none of which would accommodate the implication of an obligation of good faith in all contracts.[195] Crennan J, before her elevation, said that contractual duties of joint venturers are not necessarily or routinely subject to the implied obligation[196].

The approach adopted by the High Court in recent times is not supportive of such an obligation being implied save where it is truly necessary to prevent the contract being undermined in a significant respect. In *Byrne v Australian Airlines Ltd*[197] the court, in respect of a right of dismissal of employees, refused to imply a duty of "procedural regularity or fairness" (which falls within the description 'good faith'). Brennan CJ, Dawson and Toohey JJ said it was not necessary for the reasonable or effective operation of the employment contract[198]. McHugh & Gummow JJ said the contract of employment was not rendered nugatory, unworkable or ineffective, nor deprived of its substance, serious undermined or drastically devalued in an important respect[199], and so no such obligation should be implied.

The observations of McHugh & Gummow JJ were cited with approval in 2005 by Gleeson CJ in *Jarratt v Commissioner of Police for New South Wales*[200] where he said:

> More importantly, however, it may today be doubted whether the blanket denial of any right to procedural fairness by the Commissioner before making a recommendation under s 51(1) of the Act is necessary "lest the contract be deprived of its substance, seriously undermined or drastically devalued in an important respect". The latter expressions, respecting the necessity for implication by law of contractual terms, are those of McHugh and Gummow JJ in *Byrne v Australian Airlines Ltd*.

McHugh, Gummow and Hayne JJ also referred to and relied upon the observations in *Byrne*[201].

These cases concerned employment contracts, but the principle espoused in them has not been confined to contracts of that description. In *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd*[202] the principle in *Byrne* was applied by Gaudron, McHugh, Gummow and Hayne JJ to a commercial contract.

Whilst it is open to the High Court to reconsider past decisions, it is unlikely that the approach taken in *Byrne* would be reconsidered. That is not to say that the particular circumstances of a contract may not result in an obligation of good faith being imputed.

Some issues that may be expected to be agitated on this issue are:

- the acceptance of an implied but general obligation of good faith, from which specific obligations restricting contractual powers and rights may flow, is a departure from the usual manner in which the common law is developed. That has caused disquiet in the House of Lords, and will do so with at least Gummow and Kirby JJ, if not all of the judges. Their preference is very like to be to continue the development of the common law by reference to specific cases, as has been done in the past. Gummow J said in *Service Station Assoc v Berg Bennett*[203]:

  > It might be though a curious result if, in Australia, these principles applied to what might shortly be called 'the business efficacy test' for implied terms, whilst there was, concurrently, a term implied in the law of the loose nature of the 'good faith' criterion of performance. 'We must , of course, building upon established foundations and without destroying the symmetry of the existing building: but we need not be fearful of making additions to fill vacant spaces *if they accord with what is already standing*[204].

- the contention that a general obligation of good faith is found in the statutory provisions is similar to an argument rejected in *Byrne, where it* was sought to imply a term that an employer comply with an industrial award. By legislation Parliament identifies the specific cases in which such an obligation is imposed - generally those where there is a significant disparity in wealth and circumstance between the parties - and it would be inappropriate to extend the obligation to all contracts on that account. It is for Parliament to decide whether such an extension should occur, together with the conditions that should be imposed on its extension, not the judiciary.

- there has been long standing adherence to the *BP* test, and the *Hawkin* test has been frequently applied. The tests reflect the significance and importance of the freedom to make contracts and negotiate terms as the parties please. An implied obligation of good faith has the potential to substitute for the parties' wishes the views of a Judge as to what is commercially desirable. That is an unwarranted intrusion into the domestic affairs of the parties, and an unjustifiable restriction on their powers to decide for themselves that which is appropriate. Indeed, a Judge is unlikely to be sufficiently well informed of the

many commercial considerations that may persuade a party to seek extensive contractual discretions and powers, and for the other party to accede to that. The acceptance of an obligation of good faith would mean the abandonment, eventually, of the *BP & Hawkin* tests for the concept of an obligation of good faith could be extended to include every aspect of a contract.

There is a trend evidenced in judgments of some courts to minimise the operation of the *BP & Hawkin* tests and so allow the readier implication of terms. This is evident in the Full Court decision in *Parramatta Design & Developments Pty Ltd v Concrete Pty Ltd* [205] where it was said that "the conditions that must be satisfied before a term will be implied have become to a large extent artificially rigid", that "there has been a sensible retreat from this rigidity", that "where there is no formal contract complete on its face a more flexible approach is allowed" so that in "that kind of case all that is necessary is to show that the term to be implied is necessary for the reasonable or effective operation of the contract in all the circumstances"; and further that in respect of "a term implied as a legal incident of a particular category of contractual relationship" ... "the test is whether the term in question is 'reasonable to insert' or whether the term is required 'of necessity'[206]. The result, it was said, was that "there is a danger in approaching every case in which an implication is sought to be made as if it must fit into one or other of either a term implied in fact or one implied by law. A degree of flexibility is sometimes required ... the different kinds of implied term should be treated as 'shades on a continuous spectrum'"[207].

If followed, this approach will result in the abandonment of the *BP & Hawkin* tests in favour of 'flexibility', which is unlikely to be approved by the High Court. It is more likely the court will prefer the summary by Heydon JA in *Brambles Holdings Ltd v Bathurst City Council* that terms may be implied in only four ways, being implications contained in the express words of the contract; implications from the "nature of the contract itself " as expressed in the words of the contract; implications from usage (for example, mercantile contracts) and implications from considerations of business efficacy[208].

- the implied obligation of good faith is for the purpose of qualification of express terms. As recently as 2005 it was held by McHugh, Gummow, Hayne and Heydon JJ that "implying some qualification upon what otherwise is expressly stipulated by the contract would contradict basic principle"[209], relying upon *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*[210] and *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*[211]. It is unlikely that this principle will be reconsidered, and it serves as loud warning that the implication of an obligation of good faith generally, so as to circumscribe the operation of an express contractual discretion or power, will be rejected.

- many past decisions (as set out earlier and more) would be called into question if such an obligation was found to be implied in every contract, or every commercial contract. The

court may depart from its earlier decisions, but it is improbable it would apply such drastic surgery to the common law of Australia, not least because of the enormity of the task.

An example additional to those already discussed is *Legione v Hateley*[212] When considering equitable relief against forfeiture, the High Court permitted purchasers to challenge the termination of a contract for the sale of land but required satisfaction of the onerous requirements for relief against forfeiture (an equitable remedy). The Privy Council thought that was going too far, for in *Union Eagle Ltd v Golden Achievement Ltd*[213], it declined to follow it on the ground that it imposed an unacceptable fetter on contractual rights.

Yet in *Hungry Jack's*, a far more liberal facility to challenge termination was permitted than what was allowed in *Legione v Hateley*, that being done as a matter of common law. Whilst the decision of *Legione v Hateley* escaped the attention of the court in *Hungry Jack's*, it is unlikely to be passed over so readily in the High Court.

- there are many decisions at first instance, and at appellate level in New South Wales, where the obligation of good faith has been accepted. Elsewhere, including appellate level, it has been questioned. There are academics and jurists who accept that it is now part of the common law of Australia, and there are those who question it. It renders the matter one very likely to be given special leave in an appropriate case. Given the divergence of opinions, it is unlikely to produce in the court any concern at upsetting what may be seen by some to the settled law in New South Wales.

  Acceptance of the obligation as part of the law of New South Wales (let alone Australia) is shrouded with confusion, as was recognised by the Privy Counsel opinion in *Dymocks Franchise Systems v Todd*, where the issue was whether an implied duty of good faith arose in a franchise agreement. The litigation was brought in New Zealand and was concluded in 2004. The franchise agreement provided for the application of the laws of New South Wales, and evidence was led as to the law of New South Wales. Supporting an implied term of good faith were two leading counsel of that State; opposed to such an inference was Professor J.W. Carter of Sydney University. The trial judge found the issue too difficult to determine. The case wended its way through the appellate courts to the Privy Council. It upheld the trial judge's decision, and declined to express an opinion on the matter[214].

- the qualification of contractual rights by subjecting their exercise to a test of reasonableness, as a general proposition, has not been accepted in America, nor in England save in particular circumstances where the express terms of the contract necessitate it. It represents a significant intrusion into the freedom of parties to contract as they see fit. It raises issues as to the criteria by which the reasonableness of the conduct should be assessed, whether one party's interests should be balanced against those of the other, and some judicially imposed 'balance' enforced. Whilst that may be attractive

where there is a disparity in circumstance between the parties to a contract, it has little to commend it where the parties are well endowed financially, and have negotiated a contract armed with lawyers.

- the implication of an obligation of good faith invites the importation of a concept developed in respect of the obligations of fiduciaries. The High Court has counselled against importing fiduciary duties into contracts. Wilson J in *Hospital Products*[215] said "the Courts have often expressed a cautionary note against the extension of equitable principles into the domain of commercial relationships, so as 'not to strain (them) beyond (their) due and proper limits'[216].

In these circumstances, it is probable that the High Court will not endorse the implication of an obligation of good faith in contracts generally, nor into commercial contracts generally. It will leave open the issue of whether the terms and circumstances of a particular contract necessitates the implied obligation.

Express Terms of Good Faith

The final matter concerns the provision of an express obligation of good faith. Terms requiring good faith have been upheld.[217]

In one case, the obligation was "to act in good faith towards the defendant and take all reasonable actions to operate the Resort for the financial benefit of both the plaintiff and the defendant" [218]. In another, "the successful operation of this Contract requires that [the contractors] and [principal] agree to act in good faith in all matters relating both to carrying out the works, derivation of rates and interpretation of this document"[219]. In yet another, "each party agrees that it will act in good faith in relation to each other party with respect to all matters relating to or contemplated by this agreement"[220].

Since obligations expressed in this way have been upheld, there can be some confidence that they will be supported by the courts in the future.

There is, however, a need for some caution. There is no greater certainty as to the meaning of good faith in a written term than there is in an implied term. Its meaning is the subject of considerable debate, at least when implied, and its use as an express term thereby introduces into the contract a potentially large area of disputation, should the parties fall out.

In my opinion, it would be better to avoid the use of such a term. Other terms more certain in their operation are available. For example, an express term imposing an obligation on both parties to use best endeavours to achieve specified contractual objectives, would be less likely to give rise to such a wide dispute. If the contract provides for the use of discretionary powers, then it would be better to set out specific limits on the exercise of those powers than to resort to the generality of 'good faith'.

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1: Including *Good Faith in the Performance of Contracts*, Lexis Nexus Butterworths 2003; and papers: *Incorporating Terms of Good Faith in Contract law in Australia,* (2001) 23 Syd L.R. 222; *When Common Law Trumps Equity: the Rise of Good Faith and Reasonableness and the Demise of Unconscionability*; *The Meaning of Contractual Good Faith*; and together with Professor Carter: *Good Faith in Australian Contract Law*.

2: Adrian Baron, *Good Faith and Construction Contracts - From Small Acorns Large Oaks Grow* (2002).

3: W.D. Duncan, *The Implication of a Term of Good Faith in Commercial Leases*.

4: H.K. Lűcke, *Good Faith and Contractual Performance*, P.D. Finn *Essays on Contract*.

5: These issues cannot be addressed without reference to the standard works: *Chitty on Contracts*, (29th ed.); Cheshire & Fifoot's, *Law of Contract* (8th ed.); Carter & Harland, *Contract Law in Australia*, (4th ed.); Willmott, Christensen & Butler, *Contract Law*, (2nd ed).

6: (1995) Little Brown & Co.

7: Nicholas, *Introduction to Roman Law* (1962), p.163.

8: Whittaker and Zimmermann, *Good Faith in European Contract Law* (2000), Chapter 1.

9: *Carter v Boehm* (1766) 3 Burr. 1905; 97 E.R. 1162.

10: See *Permanent Trustee Australia Ltd v FAI General Insurance Co Ltd (in liq)* (2003) 214 CLR 514 at [67] per Gummow & Hayne JJ.

11: *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 505 at 555.

12: *Insurance Contracts Act* 1984 (Cth) Part II ss. 12, 13 and 21.

13: An examination of what reasons may have been is set out in Lűcke, *Good Faith and Contractual Performance*, Essays on Contract (1987).

14: *Insurance Contracts Act* 1984 (Cth) Part II.

15: In *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665 it was held that duty arose in equity; in *Khoury v GIO (NSW)* (1984) 165 CLR 622 it was treated as having arisen at common law. The latter is supported by the analysis of R.J. Davis, *The Origin of the Duty of Disclosure Under Insurance Law* (1991) 4 ILJ 71.

16: *Wood v Lucy, Lady Duff-Cordon* 222 N.Y. 88 (1917) Cardozo J.

17: *Kirke La Shelle Co v Paul Armstrong Co* 263 N.Y.188 (1933); 263 N.Y. 79, 87; 188 N.E. 163, 167 (1933).

18: The first major law review articles appeared in 1983 and 1968: Alan Farnsworth, *Good Faith Performance and Commercial Reasonableness under the Commercial Code*, 30 U. Chi. L. Rev 666 (1963); Robert S. Summers, *Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195 (1968).

19: Ibid at 87

20: *Centronics Corp v Genicom Corp.*, 132 N.H. 133, 562 (1989).

21: *New York Cent. Iron Works Co v United States Radiator Co.*, 174 N.Y. 331, 335.

22: A like approach was approved by the High Court in *Pan Foods Co Importers & Distributors Pty Ltd v ANZ Banking Group Ltd* (2000) 170 ALR 579 at [63] per Callinan J.

23: *Mutual Life Ins. Co v Tailored Woman, Inc.* 309 N.Y. 248.

24: *Food Fair Stores, Inc. v Blumberg,* 234 Md. 521.

25: *Goldberg 168-05 Corp. v Levy*, 170 Misc. 292.

26: *Tymshare, Inc v Covell* 727 F 2d 1145 at 1152.

27: *Re Kham* 97 Bankr 420 (Bankr ND III 1989). This followed *KMG Inc v Irving Trust Co* 757 F 2d 752 (6th Cir 1986) which found a breach by reason of the bank failing to give advance notice of its intention to deny further advances.

28: *Kham & Nate's Shoes No 2 Inc v First Bank of Whiting*, 908 F 2d 1351 at 1357.

29: *Continental Bank, NA v Everett*, 964 F 2d 701 at 705 (7th Cir) (1992).

30: *Comprehensive Care Corp v Rehabcare Corp*, 98 F 3d 1063 at 1066 (1996).

31: *United States v Basin Electric Power Co-operative*, 248 F 3d 781 at 796-98 (2001).

32: *A1 Transport v Imperial Premium Finance, Inc,* 862 F Supp 345 at 348.

33: Commencing with *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 at 265-6 per Priestly JA and most recently in *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* at [2005] FCA 401 at [62-63] per Finkelstein J.

34: Howard O Hunter, *The Growing Uncertainty About Good Faith in American Contract Law*.

35: *Transamerica Life Canada Inc v ING Canada Inc* (2003) 234 DLR (4th) 367 O'Commor ACJO & Sharpe JA.

36: Larkin JA.

37: Surprisingly, Finkelstein J in *Pacific Brands* (supra) at [64] cited this authority as supporting the adoption in Canada of the principle that the duty of good faith is an incident of every commercial contract. It is strongly arguable that it is to the contrary.

38: *Transit New Zealand v Pratt Contractors* [2002] 2 NZLR 313.

39: Notwithstanding a decision in 1992 in which the N.Z. High Court said it was not prepared to reject the notion that 'parties must act in good faith in making and carrying out the contract': *Livingston v Roskilly* [1992] 3 NZLR 230 at 237 per Thomas J. It has been held it may be implied into an agreement employing a commission agent: *LJ Stanley Ltd v Fuji Xerox NZ Ltd* (High Court, 5 November 1997).

40: P. Atiyah, *The Rise and Fall of Freedom of Contract*, OUP (1995) pp.7-15; *Bentsen v Taylor, Sons & Co (No 2)* [1893] 2 QB 274 at 281 per Bowen LJ.

41: *The Moorcock* (1889) 14 PD 64 at 68 per Bowen LJ.

42: *Hamlyn & Co v Wood & Co* [1891] 2 QB 488 at 491-493 per Lord Esher MR.

43: *Reigate v Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592 at 605 per Scrutton LJ. See also *Shirlaw v Southern Foundries* (1926) Ltd [1939] 2 KB 206 at 227 per MacKinnon LJ.

44: *Liverpool City Council v Irwin* [1977] AC 239 at 261 per Lord Wilberforce.

45: This analysis puts to one side, as not germane to the topic of this debate, the implication of terms based upon custom or usage. Custom was recognised as importing terms into commercial contracts from very early times: eg. *Wigglesworth v Dallison* (1779) 1 Dougl 201 at 207 per Lord Mansfield. However, it was very narrow in its application and is, today, virtually extinct. Trade usage has proved a more enduring basis for implying a term, provided it can be established that it is notorious, certain, reasonable and lawful: *Nelson v Dahl* (1879) 12 Ch D 568 at 575; *Dashwood v Magniac* [1891] 3 Ch 306 at 370.

46: See *Alpha Trading Ltd v Dunnshaw Patten Ltd* [1981] 1 QB 290 for an example where the different aspects were distributed between three judges.

47: (1881) 6 App Case 251, 263. There are many such cases - for a recent example see *North Sea Energy Holdings NV v Petroleum Authority of Thailand* [1999] 1 Lloyd's Rep. 482, 492.

48: *The Unique Mariner (No 2)* [1979] 1 Lloyd's Rep 37 and many earlier cases.

49: *Trollope v Martin* [1934] 2 K.B. 436.

50: *Richo International Ltd v Alfred C. Toepfer International Gmbh* [1991] 1 Lloyd's Rep 136, 144.

51: *William Cory & Son Ltd v London Corporation* [1951] 2 KB 476 at 484.

52: *Hughes v Metropolitan Ry* (1877) 2 App Cas 439.

53: Initially confined to leases and sales of land but extended more generally in 1954: *Stockloser v Johnson* [1954] 1 QB 476; only to be restricted later to forfeiture of proprietary or possessory rights: *Scandinavian Trading Tanker Co AB Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694. The same is the case in Australia: *Legione v Hateley* (1983) 46 ALR 1; *Ciavarella v Balmer* (1983) CLR 348; *Stern v McArthur* (1988) 165 CLR 489.

54: *Re Anglo-Russian Merchant Traders Ltd* [1917] 2 KB 679 (CA); *Brauer & Co (Great Britain) Ltd v James Clark (Brush Materials) Ltd* [1952] 2 All ER 497 [[1952] 2 Lloyd's Rep 147] (CA).

55: *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co* [1915] AC79, 86-88 per Lord Dunedin.

56: *Paragon Finance plc v Staunton* (2002) 2 All ER 248.

57: *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555 at 572–3; 1 All ER 125 per Viscount Simonds.

58: *Liverpool City Council v Irwin* (supra) at 258 per Lord Cross.

59: *Liverpool City Council v Irwin* (supra) at 254 per Lord Wilberforce; see also *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80; [1985] 2 All ER 947

60: In *Liverpool City Council v Irwin* (supra), Lord Denning in the Court of Appeal implied a term solely on the ground of reasonableness. The House of Lords rejected that, but implied the same term on the ground of necessity (albeit conceding that if it needed to be reasonable as well).

61: See Reiter, "*Good Faith in Contracts*" (1983) 17 Valparaiso U.L. Rev 705 at 709 et seq.

62: Bridge, "*Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?*" (1984) 9 Can Bus LJ 385 at 409.

63: The Ontario Law Reform Commission reported that 'while good faith is not yet an openly recognised contract law doctrine, it is very much a factor in everyday contractual transactions. To the extent that the common law of contracts, as interpreted and developed in our courts, reflects this reality, it is accurate to state that good faith is a part of our law of contracts. In this vein, a great man well established concepts in contract law reflect a concern for good faith, fair dealing and the protection of reasonable expectations, creating a legal behavioural baseline.': *Report on Amendment of the Law of Contract* (1987) at 166.

64: *Watford v Miles* [1992] 2 AC 128,138.

65: *James Spencer & Co Ltd v Tame Valley Padding Co Ltd*, unreported, 8 April 1998.

66: *Bank of Novia Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1990] 1 QB 818, 894.

67: *R (European Roma Rights Centre) v Immigration Office at Prague Airport (United Nations High Commissioner for Refugees Intervening)* [2005] 2 WLR 1, 37. Justice Finkelstein attributed this to an attitude that regarded predictability in the legal outcome of a case as more important than justice: *Pacific Brands* (supra) at [61]. It was alleged there was a contravention of the *1951 Convention and Protocol Relating to Refugees*. The argument was that steps had been taken to ensure the Convention did not apply to the applicants, and that was contended to be contrary to an international principle of good faith. Lord Hope, having explained the differing jurisprudential approaches, accepted that in international law there was a principle of good faith, holding that it was not a source of obligation where none otherwise existed, being the sense in which it was used in Roman Law. He did not elevated predictability of outcome above justice, and it is not a fair summary of his judgment to suggest that he did.

68: *Interfoto Picture Library Ltd v Stilleto Visual Programmes Ltd* [1989] 1 QB 433, 439. Bingham LJ gave as illustrations of these solutions equity's striking down of unconscionable bargains, statutory control of exemption clauses and hire purchase, and the ineffectiveness of penalty clauses. See similarly, *Director General of Fair Trading v First National Bank* [2002] 1 AC 507 at [17].

69: *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514 at [218-219].

70: *Unfair Contract Terms Act 1977 (UK)* ss. 2, 3, 6 and 11.

71: Dir. 93/13/EEC.

72: *Unfair Terms in Consumer Contracts Regulations 1994 (UK)* reg. 4(1).

73: Dir. 86/653/EEC Art 3(1); *Commercial Agents (Council Directive) Regulations* 1993 (UK) reg. 3(1).

74: For example, Dir.2002/65/EC concerning marketing of financial services which refers to principles of good faith.

75: Whittaker and Zimmermann, *Good Faith in European Contract Law* (2000), Chapter 1.

76: *Director General of Fair Trading v First National Bank* [2001] UKHL 52 at [17].

77: *Chandler v Hunter* 340 So. 2d 818; *Tanner v Church's Fried Chicken, Inc.*, 582 So. 2d 449 (Ala. 1991).

78: Burton & Andersen, *Contractual Good Faith* (1995) §1.1.

79: (1977) 180 CLR 266 at 282-283.

80: *Secured Income Real Estate (Australia) Ltd v St Martin's Investments Pty Ltd* (1979) 144 CLR 596 at 605-6; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347; *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 66, 117-18; *Moorgate Tobacco Co Ltd v Philip Morris Ltd (No 2)* (1984) 156 CLR 414 at 435; 56 ALR 193; *Adelaide City Corporation v Jennings Industries Ltd* (1985) 156 CLR 274 at 281-2; 57 ALR 455; *Hawkins v Clayton* (1988) 164 CLR 539 at 571-3; 78 ALR 69; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at 422, 441; 131 ALR 422; *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588; *Moneywood Pty Ltd v Salamon Nominees Pty Ltd* (2001) 202 CLR 351 at [80]; *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516 at [157-159.]

81: *Hawkins v Clayton* (1988) 164 CLR 539 at 573 per Deane J; see earlier suggestion in *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 121 per Deane J; adopted by other members of High Court: *Byrne & Frew v Australian Airlines Ltd* (1995) 185 CLR 410; *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588;

82: *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468 at 486–7 per Hope JA. The implication of a term as a matter of law, as distinct from implication in order to give business efficacy has been recognized by the High Court: *Esso Australia Resources Ltd v Plowman* (1995) 183 CLR 10 at 30; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at 447–8.

83: Typically, where it establishes a fiduciary relationship such as trustees, guardians, partners, directors, solicitors, agents and so on.

84: The rule in *Butt v McDonald* (supra). Endorsed by *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (supra) at 607; *Hospital Products Ltd v United States Surgical Ltd* (supra) at 659; *Nullagine Investments Pty Ltd v Western Australia Club Inc* (1993) 177 CLR 635 at 647, 659; *Fitzgerald v F J Leonhardt Pty Ltd* (1997) 189 CLR 215 at 219; *Peters (WA) Ltd v Petersville Ltd* (2001) 181 ALR 337 at 348.

85: *Howtrac Rentals Pty Ltd v Thiess Contractors (NZ)* [2000] VSC [415] at [414-421].

86: *Australis Media Holdings Pty Ltd v Telstra Corp Ltd* (1998) 43 NSWLR 104.

87: *Laurelmont Pty Ltd v Stockdale & Leggo (Queensland) Pty Ltd* [2001] QCA 212 at [39].

88: *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (supra).

89: *Electronic Industries Ltd v David Jones Ltd* (1954) 91 CLR 288 at 297; *Thorby v Goldberg* (1964) 112 CLR 597 at 603; *Wigan v Edwards* (1973) 47 ALJR 586 at 591; *Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd* (1982) 149 CLR 600.

90: *Commonwealth v Amman Aviation Pty Ltd* (1991) 174 CLR 64 at 96.

91: *King v Poggioli* (1923) 32 CLR 322; *DTR Nominees Pty Ltd v Mona Homes Pty Ltd* (1978) 138 CLR 423 at 433; *Foran v Wight* (1989) 168 CLR 385 at 397-402.

92: *Meehan v Jones* (1982) 149 CLR 571 at 592. On this occasion the court found it unnecessary to determine whether reasonableness was required as well as honesty, though the majority favoured honesty alone: at 580-1, 590-1, 598. Earlier, in *Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd* (1972) 128 CLR 592 the termination failed because it was unreasonable (at 546, 552) or unconscionable (at 538).

93: *Ansett Transport Industries v Commonwealth* (1977) 139 CLR 54 at 61.

94: *Reg Glass Pty Ltd v Rivers Locking Systems Pty Ltd* (1968) 120 CLR 516.

95: Steyn, J, *The Role of Good Faith and Fair Dealing in Contract Law*, 16 May 1991.

96: Sir Anthony Mason, *Contract and its Relationship with Equitable Standards and the Doctrine of Good Faith*, The Cambridge Lectures, 1993 (and see 116 LQR 66).

97: For some reason, many refer to this the Arbitrator acting “as amiable compositeur or ex aequo et bono”, which only serves to bewilder and confuse the average commercial party.

98: Some reliance was placed by Priestly JA in *Renard* (at 269) on the joint observations of Mason CJ & Dawson J in *Amann* at (1991) 66 ALJR 135 where they referred to a submission that there was no obligation to act impartially, but when the report is read, it can be seen that there was no challenge made in the High Court to the Federal Court interpretation of the clause in question. Further, there was no suggestion in the Federal Court decision that there was a general obligation to act in good faith. The Federal Court decision is considered later under a separate heading.

99: *Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd* (1972) 128 CLR 529 at 548.

100: *Pierce Bell Sales Pty Ltd v Frazer* (1973) 130 CLR 575 at 587 per Barwick CJ.

101: (1993) 45 FCR 84 at pp 91–99.

102: (1988) 15 NSWLR 130 at 132–3.

103: (1997) 76 FCR 151

104: (1998) 44 NSWLR 349.

105: Ibid, at 369.

106: [2001] NSWCA 187 at [163], [182-186].

107: [2004] NSWCA 15 at [189], [191].

108: (2004) 135 FCR 105.

109: (2002) 26 WAR 33.

110: *Presmist Pty Ltd v Turner Corporation Pty Ltd* (1992) 30 NSWLR 478; *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91; *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Australian Co-operative Foods Ltd v Norvo Co-operative Ltd* (1999) 46 NSWLR; *Aiton Australia Pty Ltd v Transfield Pty Ltd* (2000) 16 BCL 70; *Apple Communications v Optus Mobile Pty Ltd* [2001] NSWSC 635; *LMI Australia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 856; *State of New South Wales v Banabelle Electrical Pty Ltd* (2002) 54 NSWLR 503; *Commonwealth Development Bank of Australia Ltd v Cassegrain* [2002] NSWSC 965; *Softplay Pty Ltd v Perpetual Trustees (WA) Pty Ltd* [2002] NSWSC 1059; *Commonwealth Bank of Australia v Spira* [2002] NSWSC 905; *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 17.

111: *Pacific Brand* (supra) at [63].

112: *Golden Sands Pty Ltd v Davegale Pty Ltd* [2003] VSC 458 at [39].

113: *Cathedral Place Pty Ltd v Hyatt of Australia Ltd* [2003] VSC 385 at [53].

114: *Codelfa Construction Pty Ltd v State Railway Authority of NSW* (1982) 149 CLR 337 at 345; *Byrne v Australian Airlines Ltd* (1995) 131 ALR 422 at 426.

115: *Astley v Austrust* (1999) 197 CLR 1 at 22.

116: *Hospital Products* (infra) at 64, 91-2, 118.

117: *Esso Australia Resources Ltd v Plowman* (1995) 69 ALJR 404.

118: *Castlemaine Tooheys Ltd v Carlton & United Brewers* (1987) 10 NSWLR 468 at 487; *Burger King* (supra) at [166-167].

119: *Breen v Williams* (supra) at 103, 124.

120: *Breen v Williams* (supra) at 103, 124; *Byrne* (supra) at 450.

121: (1923) 34 CLR 71.

122: (1990) 22 FCR 527

123: At 532 per Davies J.

124: At 542 per Shepherd J.

125: (1997) 146 ALR 1.

126: Ibid, at 35.

127: Ibid, at 36.

128: Ibid, at 41.

129: Whilst excusing the decision-maker of fault, Meagher JA concluded that the denial of information robbed the decision of its legal effect, as the mind of the decision maker had not addressed the matter as the contract required.

130: *Renard Constructions (ME) v Minister* (supra) at 270-271.

131: *Renard Constructions (ME) v Minister* (supra) at 279.

132: *Renard Constructions (ME) v Minister* (supra) at 260-263.

133: Priestly JA said this conclusion had been reached in an earlier Court of Appeal decision: *Progress & Properties (Strathfield) Pty Ltd v Crumblin* (1985) NSW ConvR 55-225. An examination of the reasons in that case reveals that Glass JA identified the divergence of opinion in *Meehan v Jones*, and did no more than note that the trial judge had acted on the basis that reasonableness must be shown but said it was satisfied. Since the appeal was dismissed, it could not be sustained that the Court of Appeal in this decision supported the proposition upon which Priestly JA relied.

134: This was an essential element in his reasoning, for he acknowledged that on the authority of *Stahard v Lee* (1863) 122 ER 138 all that need be demonstrated was that the power to terminate was exercised honestly (see *Renard Constructions (ME) v Minister* 280).

135: This reasoning is not very persuasive, for whilst an Arbitrator is not bound by what a party has done, where that is the subject of dispute, the Arbitrator is still bound to determine the dispute in accordance with law, and if the obligation is satisfied by an honest exercise of discretion, that is the only issue the Arbitrator should determine.

136: That the Court imposes a term where it thinks that policy requires it is emphasised by the NSW CA in *Australis Media Holdings Pty Ltd v Telstra Corporation* (1998) 43 NSWLR 104 at 123.

137: *Service Station Assoc v Berg Bennett* (supra) at 95.

138: In *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468 at 487, Hope JA considered authorities which suggested that such a term might also be implied where the nature of the contract itself implicitly required it as a matter of necessity. The sense of "necessity'' was that conveyed by Holmes' phrase, "The felt necessities of the time'', and indicates something required in accordance with current standards of what ought to be the case, rather than anything more absolute. This was referred to without determination by the Full Court (with Gummow J a member) in *Devefi Pty Ltd v Mateffy Perl Nagy Pty Ltd* (1993) 113 ALR 225 and again referred to by Gummow J in *Service Station Assoc v Bennett* (supra).

139: *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226 at 236.

140: *Service Station Assoc v Bennett* (supra) at 92 per Gummow J, relying upon observations by Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith* (1980) 94 Harv L Rev 369-370.

141: Ibid, at 369.

142: Supra at [163], [182-186].

143: As espoused by Windeyer J in *Apple Communications Ltd v Optus Mobile Pty Ltd* [2001] NSWSC 635 at [15].

144: [2004] NSWCA 15 at [189], [191].

145: [2005] NSWSC 540 per McDougall J.

146: *Gary Rogers Motors (Aust) Pty Ltd v Sabaru (Aust) Pty Ltd* (1999) ATPR 41-703.

147: *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310; *Banco Villa Pty Ltd v Montedeen Pty Ltd* [2001] VSC 192.

148: *Overlook Management BV v Foxtel Management Pty Ltd* (supra).

149: *Laurelmont Pty Ltd v Stockdale & Leggo (Qld) Pty Ltd* [2001] QCA 212.

150: *Central Exchange v Anaconda Nickel Ltd* [2002] WASCA 94.

151: *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108.

152: *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228.

153: See *Pacific Brands* (supra) at [63].

154: *Wenzel v Australian Stock Exchange Ltd* [2002] FCAFC 400 at [81].

155: Carter & Peden, *Good Faith in Australian Contract Law* (2003) 19 Journal of Contract Law.

156: See, for example, *APLA Ltd v Legal Services Commissioner (NSW)* (2005) 219 ALR 403 at [469] per Callinan J; *Parramatta Design & Developments Pty Ltd v Concrete Pty Ltd* [2005] FCAFC 138 per Fed Crt FC at [12];

157: *Hughes Aircraft Systems International v Airservices Australia* (supra) at 191-193, per Finn J; *Alcatel Australia Ltd v Scarcella* (supra) at 368-369, per Sheller JA; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (supra) at [37] per Finkelstein J; *Far Horizons Pty Ltd v McDonald's Australia Ltd* (supra) at [120] per Byrne J;

158: Dubbed by academics as the 'excluder theory' and approved by Priestly JA in *Renard Constructions (ME) v Minister* (supra) at 266-267.

159: *South Sydney District Rugby League Football Club Ltd v News Ltd* [2000] FCA 1541 at 426 per Finn J; *Overlook v Foxtel* (supra) at [67].

160: *Aiton Australia Ltd v Transfield Pty Ltd* [1999] 153 FLR 237 at 263-265.

161: *Overlook v Foxtel* (supra) at [67].

162: *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (supra) where Finkelstein J stated: "In my view, a term of a contract that requires a party to act in good faith and fairly imposes an obligation upon that party not to act capriciously. ..."; see also *Hoppers Crossing Club Ltd v Tattersalls Gaming Pty Ltd* [2005] VSC 114 at [25] per Kaye J.

163: See *Amann Aviation Pty Ltd v Commonwealth* (supra) at 533 per Davies J and the authorities referred to therein.

164: *Laurinda Pty Ltd v Capalaba Park Shopping Centre Pty Ltd* (1989) 166 CLR 623 at 624.

165: *Hospital Products Ltd v United States Surgical Corp* (supra) at 137-8; *Hughes Aircraft Systems International v Airservices Australia* (supra) at 39.

166: *Gary Rogers Motors (Aust) Pty Ltd v Sabaru (Aust) Pty Ltd* (supra); *Alcatel Australia Ltd v Scarcella* (supra); *Walker v ANZ Banking Group (No 2)* (2001) 39 ACSR 557.

167: *Contract - The Burgeoning Maelstrom* (1988) 1 JCL 15 at 28.

168: See, for example, *Burger King* (supra) at [159], [163], 164]; *Elfic Ltd v Macks* [2000] QSC 18 [2000] QSC 18 at [109] per Williams J; *Commonwealth Bank of Australia v Renstell Nominees Pty Ltd* [2001] VSC 167 at [47] per Byrne J; *NSW v Barnabelle Electrical Pty Ltd* [2002] NSWSC 178 per Einstein J.

169: *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703 at 43014; *Lay v Alliswell Pty Ltd* (2002) V Conv R 54-651 at [31] per Balmford J.

170: *Meehan v Jones* (supra) at 591 per Mason J; *Gregory v MAB Pty Ltd* (1989) WAR 1; *Paltara Pty Ltd v Dempster* (1991) 6 WAR 8; *Bamford v Pozenel* [2001] SASC 132 at [13].

171: *South Sydney District Rugby League Football Club Ltd v News Ltd* (supra) at [426] per Finn J.

172: Examples may be found in *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (supra); *South Sydney District Rugby League Football Club Ltd v News Ltd* (supra); *Far Horizons Pty Ltd v McDonald's Australia Ltd* (supra);

173: *Hughes Aircraft Systems* (supra).

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

175: *Edensor Nominees Pty Ltd v Anaconda Nickel Pty Ltd* [2001] VSC 502 at [188-190].

176: *Burger King* (supra).

177: *South Sydney District Rugby League Football Club Ltd v News Ltd* (supra) at [393]; *Alcatel Australia Ltd v Scarcella* (supra) at 369-370; *Advance Fitness Corp Pty Ltd v Bondi Diggers Memorial & Sporting Club Ltd* [1999] NSWSC 264 at [122]; LMI *Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886 at [75].

178: *Hughes Aircraft Systems* (supra) at 41.

179: *Overlook v Foxtel* (supra) at [68].

180: *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (supra); *Far Horizons Pty Ltd v McDonald's Australia Ltd* (supra)

181: *South Sydney District Rugby League Football Club Ltd v News Ltd* (supra).

182: Willmott, Christensen, Butler, *Contract Law* at 288.

183: *Secretary of State for Employment v ASLEF (No 2)* [1972] 2 QB 452 at 455 per Roskill LJ; followed by *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286 per Hasluck J.

184: *Meehan v Jones* (supra).

185: See *Bank IV Salina NA v Aetna Casualty & Surety Co*, 810 F Supp 1196 at 1205 (D Kansas 1992).

186: Though it has been advanced by academics: see *Cheshire & Fifoot's Law of Contract*, 8th ed. 2002 para 10.43.

187: *GSA Group v Siebe Plc* (1993) 20 NSWLR 573 Rogers J; Castlemaine Tooheys (1987) 10 NSWLR 468 at 490-493; *Devefi Pty Ltd v Mateffy Pearl Nagi Pty Ltd* (1993) 113 ALR 225 at 240-241; *Byrne v Australian Airlines* (supra) at 449 per McHugh and Gummow JJ.

188: This is accepted by Finkelstein J, notwithstanding his advocacy of the implied obligation: *Pacific Brands* (supra) at [64].

189: *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at 443 per McHugh and Gummow JJ; and see also *Aldersea v Public Transport Corporation* [2001] 3 VR 499 per Ashley J; *Johnson v Unisys Ltd* [2001] 2 All ER 801 per Lord Steyn, 817–20 per Lord Hoffmann and 823 per Lord Millett.

190: *Renard Constructions (ME) v Minister* (supra) at 279.

191: Joint judgment at [40]; Callinan J at [156].

192: *Service Station Assn Ltd v Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84 at pp 91–99

193: At [88].

194: Referring to *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 at 283; 16 ALR 363 at 376–7 (PC); *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337 at 353; 41 ALR 367 at 375–6; *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 121–2; 55 ALR 417 at 472–3; *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Aust) Ltd* (1986) 160 CLR 226 at 241; 64 ALR 481 at 489; *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 185 ALR 335 at 379–2 [156]–[164]; *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (supra) at 256; cf *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84 at 96–7; 117 ALR 393 at 406.

195: *Brambles Holdings Ltd v Bathurst City Council* (2001) 53 NSWLR 153.

196: *Gibson Motor Sport Merchandise Pty Ld v Forbes* [2005] FCA 749 at [79].

197: (1995) 185 CLR 410.

198: Ibid, at 422.

199: Ibid, at 453.

200: (2005) 221 ALR 95 at [78].

201: Ibid, at [78].

202: (2000) 202 CLR 588 at [46].

203: *Service Station Assoc v Berg Bennett* (supra) at 95.

204: Citing *Smith v Jenkins* (1970) 119 CLR 397 at 417 per Windeyer J.

205: [2005] FCAFC 138; (2005) 144 FCR 264; (2005) 219 ALR 373.

206: Ibid at [13-15] per Branson, Kiefel and Finkelstein JJ.

207: Ibid at [16].

208: Ibid at [28].

209: *Koehler v Cerebos (Australia) Ltd* (2005) 214 ALR 355 at [36].

210: (1982) 149 CLR 337 at 347; 41 ALR 367 at 371.

211: (1977) 180 CLR 266 at 283; 16 ALR 363 at 376–7.

212: (1983) 152 CLR 406.

213: [1997] AC 514.

214: *Dymocks Franchise System v Todd* [2004] 1 NZLR 289 at [47-57]; [2005] 4 All ER 195.

215: *Hospital Products Ltd v United States Surgical Corporation* (1984-1985) 156 CLR 40 at 70 per Gibbs CJ, 118–119 per Wilson J and at 149–150 per Dawson J; see also *Scandinavian Trading Tanker Co A B v Flota Petrolera Ecuatoriana* [1983] AC 694 at 703, 4 and *Keith Henry & Co Pty Ltd v Stuart Walker & Co Pty Ltd* (1958) 100 CLR 342.

216: Relying on like observations by Lord Selborne LC in *Barnes v Addy* (1874) 9 Ch App 244, at p 251.

217: *Casinos Austria International (Christmas Island) Pty Ltd v Christmas Island Resort Pty Ltd* [1998] WASC 387; *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* [2000] WASCA 102; 196 ALR 257 (appeal to HC); *Optus Networks Pty Limited v Telstra Corp Ltd* [2001] FCA 1798.

218: *Casinos Austria International* (supra).

219: *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (supra).

220: *Optus Networks Pty Limited v Telstra Corp Ltd* (supra).