THE MEANING OF ‘GOOD FAITH’ IN COMMERCIAL CONTRACTS IN AUSTRALIA

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1. INTRODUCTION

As the literature and cases demonstrate a definitive discussion on good faith in Australian contract law can run to pages, is loosely grouped in two predominant schools of thought and practically results in different outcomes dependent on a variety of case specific factors.

This uncertainty has largely arisen as a result of the lack of High Court determination on the issue, despite the acknowledgment in the 2002 case of Royal Botanic Gardens and Domain Trust v South Sydney City Council, that while “the issues respecting the existence and scope of a ‘good faith’ doctrine are important”, that case and none since then have been considered appropriate to consider them.

This paper aims to provide a summary of the current status of good faith in Australian contract law, which will entail addressing the recurrent problematic issues, being, what is good faith, and, in what circumstances will good faith commonly be found to exist. Some specific comments will then also be made in relation to drafting and enforcement good faith considerations to put the debate, its current uncertainty and its impact on business relations in context.

2. WHAT IS GOOD FAITH IN AUSTRALIA?

What ‘good faith’ exactly comprises has developed over time as a result of court determinations and remains without a closed and precise definition leading to vagueness as to the exact delimitations of what comprises good faith.

A starting point cited for determining what constitutes ‘good faith’ is an article by the Hon Sir Anthony Mason, a former Chief Justice of the High Court of Australia, who stated that the duty of good faith probably embraced three related notions:

“(1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);

(2) compliance with honest standards of conduct;
(3) compliance with standards of conduct which are reasonable having regard to the interests of the parties.”

The third element has been the subject of judicial and academic criticism.

Renard Constructions (ME) Pty Ltd v Minister for Public Works, provides the basis for the emergence of a line of authority that creates a common law obligation of good faith in commercial contractual performance and enforcement.

Allsop P said that “the phrase ‘good faith’ … takes its content from the particular contract and context in which it is found”.

Case decisions as a result have noted good faith as:

(a) not bad faith such as parties not acting opportunistically or using contract terms for purposes antithetical to the contract that are calculated to extract value from the other contracting party;

(b) requiring parties to act honestly;

(c) not acting arbitrarily, capriciously, unreasonably or recklessly;

(d) not requiring a party to act in the interests of the other party to the contract;

(e) not “imposing obligations on the parties that, in effect, inconsistent with the terms” of the contract;

(f) incorporating reasonableness; and

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4 In Renard a principal terminated a contract pursuant to a ‘show cause’ procedure, based on misleading and prejudicial information. The Court found that the principal’s conduct did not comply with an implied term to act reasonably. Priestley JA held that clause 44.1 of the contract ‘should be construed as requiring the principal to act reasonably as well as honestly’. He went on to draw an analogy to the kind of reasonableness he had referred to and the notion of good faith stating: Although this implication has not yet been accepted to the same extent in Australia as part of judge-made Australian contract law, there are many indications that the time may be fast approaching when the idea, long recognised as implicit in many of the orthodox techniques of solving contractual disputes, will gain explicit recognition in the same way as it has in Europe and in the United States.
5 Supra n.6.
7 Ibid at [560].
8 Ibid at [558].
(g) being equated with fair dealing\(^{19}\).

But as noted in the introduction to this paper as yet there is no High Court guidance on good faith at this point.

3. **IN WHAT CIRCUMSTANCES WILL GOOD FAITH COMMONLY ARISE?**

Predominantly three views are advanced as the doctrinal basis for good faith in Australia\(^{20}\), these being:

(a) as a general principle of contract construction\(^{21}\);

(b) as a term implied as a matter or law; or

(c) as a term implied as a matter of fact.

The first of these has been largely an academic discussion that has not found much favour with the judiciary\(^{22}\).

The second and third views have received competing support in bodies of case law over the past 20 years or more resulting in a variety of outcomes for parties to proceedings.

The most common instances where good faith has been considered by the Courts arise where there is either:

(d) an express term incorporated into the contract\(^{23}\);

(e) where a term is implied into a contract (either as a matter or law or as a matter of fact); or

(f) where legislative intervention stipulates good faith is to apply.

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18 Aquila Coal Pty Ltd v Bowen Central Coal Pty Ltd & Anor [2011] QSC 264.
19 See RPR Maintenance Pty Ltd v Marmax Investments Pty Ltd [2014] FCA 409, where the court said that “implied terms of good faith, fair dealing and providing the other party with the benefit of the agreement ought to be read into the sub-franchise agreement”.
20 Australian Contract Law Commentary, CCH, Terms, Good Faith in Contract, based on a paper written by the Hon Justice Margaret Beazley AO, President, New South Wales Court of Appeal, in conjunction with Myles Pulsford, 9 March 2013.
22 See comments of Giles JA in Vodafone Pacific Pty Ltd v Ors v Mobile Innovations Ltd [2004] NSWCA 15 at [205-206]; Insight Oceania Pty Ltd v Philips Electronics Australia Ltd [2008] NSWSC 710 at [713].
23 Lending itself to the application of the relatively settled contractual interpretation principles to determine what is meant and how good faith is to be applied in the context of that contract, however not without some notable exceptions. See Carter, J, “Good faith in Contract: Why Australian Law is Incoherent” Revised version of a paper presented at the Bar Association of Queensland 2014 Annual Conference, Saturday 8 March 2014.
4. **EXPRESS TERMS**

4.1 **Content and application**

Express terms of good faith incorporated into a contract can often include:

(a) broad overarching style obligations such as - the parties will act in good faith to give effect to the terms of the contract; or,

(b) more circumscribed obligations such as - the parties will participate in a mediation or other dispute resolution process [under a dispute resolution provision] in good faith;

The Courts approach to the application of these clauses is usually fairly uncontroversial utilising the usual contract interpretation principles applied to the existing fact situations.

This has lead to the exposition of what good faith is, and is not, in the cases of various jurisdictions. Some examples are summarised below.

4.2 **Auto Masters Australia Pty Ltd v Bruness Pty Ltd**\(^{24}\)

(a) **Facts**

Auto Masters had granted a franchise agreement to Bruness.

Clause 15 of the franchise agreement stated:

"The Franchisor will use its best endeavours to promote the performance and success of the Franchise Business and will deal at all times with the Franchisee in absolute good faith".

Bruness experienced difficulty in accurately processing invoices using the purpose built computer software provided by Auto Masters as part of the franchise. These difficulties lead to meetings which failed to resolve the issues. Auto Masters issued Bruness with several notices of default/to remedy breach alleging a failure to comply with Auto Masters operations manual.

Bruness denied it was in breach saying that Auto Masters had failed to support it by failing to provide an efficient computer system and made counter allegations to the ACCC, which did not become involved. Auto Masters purported to terminate the franchise agreement as a result of a failure to remedy the non-compliance.

\(^{24}\) [2002] WASC 286
(b) **Court Findings**

The Court found that the grounds upon which Auto Masters purported to terminate the franchise agreement were insufficient. The Court said that Auto Masters own document management system did not accurately represent the state of compliance by Bruness in managing its documents.

Given the doubtful foundations for their actions, Auto Masters not only acted capriciously and unreasonably, but also failed to recognise and have due regard to the legitimate interests of both parties. There was an element of oppression in Auto Masters conduct.

Accordingly Auto Masters was in breach of the good faith term of the franchise agreement and Bruness was entitled to the relief sought to injunct termination of the franchise agreement.

(c) **Points to take away from case**

Hasluck J cited approvingly Renard’s case and reiterated that “what constitutes good faith will depend upon the circumstances of the case and upon the context of the contract as a whole. The courts will allow normal and reasonable business behaviour, with the result that the parties are not obliged to put aside their own self-interest or proprietary rights. A court considering such a provision is entitled to have regard to the reasonableness of the conduct and whether a party has acted unconscionably or capriciously. This may require the court to give some consideration to the motivation underlying the relevant events.”

His Honour also referred to the observations of Finkelstein J in *Garry Rogers Motors (Aust) Pty Ltd* (1999) ATPR 41-703 regarding “that in appropriate contracts, perhaps even in all commercial contracts, a good faith and fair dealing term would ordinarily be implied” and Barrett J in *Overlook v Foxtel* (2002) ATPR(Digest) 46-219, that “the duty is not to prefer the interests of the other contracting party. It is, rather, a duty to recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.”

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25 Supra at [353].
26 Supra at [357].
4.3 *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service*

(a) **Facts**

Macquarie International Health Clinic (Macquarie) entered into a heads of agreement with Sydney South West Health Service (SSWBS) for the development of a private hospital on land on the precinct of the Royal Prince Alfred Hospital (RPAH).

The land was owned by SSWBS.

The heads of agreement contained an express term in clause 15.4 which stated:

“*Without limiting the generality of any other provision of this agreement, the parties agree that in the performance of their respective duties and the exercise of their respective powers under this agreement and in their respective dealings with each other, they shall act in the utmost good faith.*”

It was an essential term of the deal that the private hospital be built next to and physically linked to the Prince Alfred.

However, after the agreement was signed, SSWBS undertook an asset strategic plan for RPAH which did not propose any development consistent with the agreement which it had with Macquarie to ensure that the new building would link to the RPAH. This was not disclosed to Macquarie.

Macquarie claimed that SSWBS had subsequently breached its obligation to act in good faith as it had failed to disclose the strategic plan amongst other items.

(b) **Court findings**

The NSW Court of Appeal held that the express obligation of ‘good faith’ in the contract was enforceable.

It said that ‘good faith’ does not require parties to sacrifice their own commercial interests but parties must cooperate in a reasonable way to achieve the contract objectives.\(^{28}\)

This co-operation may involve disclosing important information to the other party.

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\(^{27}\) [2010] NSWCA 268.

\(^{28}\) *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2012] NSWCA 268, [3].
Additionally, the court held that ‘negotiating in good faith’ has an objective element of reasonableness in fair dealing, taking its place with honesty to the bargain in the furtherance of the contractual objects and purposes of the parties, objectively obtained.\textsuperscript{29}

In the case at hand, SSWHAS should have disclosed the asset strategic plan since the information was likely to make a substantial difference to Macquarie’s reasonable expectations under the head of agreement.

SSWHAS therefore breached their ‘good faith’ obligation.

(c) Points to take away from the case

This case highlights the fundamental importance of terms such as ‘good or utmost faith’ in heads of agreement, letters of intent and memoranda of understandings.

This decision emphasises some of the benefits of including ‘good faith’ clauses where a court finds that it is sufficiently clear to give effect to the express term.

The ‘good faith’ clause provided an additional contractual obligation against the situation where the other party did not disclose important information or fails to act honestly and sincerely.

4.4 Aquila Coal Pty Ltd v Bowen Central Coal Pty Ltd & Anor\textsuperscript{30}

(a) Facts

Aquila and Bowen were joint venture partners in a coal mine development. A feasibility study was undertaken for mine development which had two scenarios. The parties had to vote on options and if two successive no votes occurred buy/sell options were triggered under the agreement.

Injunctive action was taken to prevent second meeting being held and the second successive no vote occurring triggering the buy/sell option which was alleged to be being used as a mechanism to exert pressure for sale to acquire Aquila’s share at an under value by Bowen.

Aquila alleged that Bowen had contravened clause 2.11 of the joint venture agreement which stated:

\textsuperscript{29} Ibid, [6].
\textsuperscript{30} [2011] QSC 264
“The Participants will at all times act in good faith and in the best interests of the Joint Venture and the Participants must make their respective interests in the Tenements and the other Venture Property available for the purpose of the Joint Venture.”

(b) **Court Findings**

His Honour found that there was a substantial case that Bowen had not acted in good faith or in the best interests of the Joint Venture by seeking to propose a scenario for mine development that would see significant expenditure prior to an income revenue being generated, ostensibly with a view to acquiring the other party’s interest in the development.

On that basis the application for interlocutory injunction was granted noting that the substantive proceedings were running contemporaneously to determine the issues raised.

(c) **Points to take away from case**

Applegarth J states whilst noting it is unnecessary to essay the law about the content of a contractual obligation of good faith, “adopts the observations of Hodgson J in Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service to the effect that a contractual obligation of good faith embraces no less than three related notions:

(i) an obligation on the parties to co-operate in achieving the contractual objects;

(ii) compliance with honest standards of conduct;

(iii) compliance with standards of conduct that are reasonable having regard to the interests of the parties.”

Justice Applegarth also noted the comments in respect to a contractual obligation of good faith “not requiring a party to act in the interests of the other party or to subordinate its own legitimate interests to the interests of the other party; although it does require it to have due regard to the legitimate interests of both parties.”

He also cited Allsop P’s comments on the usual content of the obligation of good faith including:

(iv) obligations to act honestly and with fidelity to the bargain;
(v) obligations not to act dishonestly and not to act to undermine the bargain entered or the substance of the contractual benefit bargained for; and

(vi) an obligation to act reasonably and with fair dealing having regard to the interests of the parties ... and to the provisions, aims, and purposes of the contract, objectively ascertained.

His Honour further cited approvingly Allsop P’s comments that “the content of an express obligation to act in good faith in any case, is to be understood and ascertained by construing the language of the parties in the context in which the clause appears. The obligation must be assessed and interpreted in the light of the bargain and its contractual terms”.

4.5 Minumbra Lancewood Pty Ltd v AM Lancewood Investment Nominees Pty Ltd

(a) Facts

The parties entered into a venture to acquire and operate an accommodation village of some 348 rooms to provide housing for transient construction workers on a short term basis in the Bowen Basin in Queensland.

Minumbra as trustee of a unit trust borrowed money from AM Lancewood in order to acquire the joint venture assets. The loan agreement contained provisions which stated:

That the Lender and the Borrower must “meet to consider and discuss in good faith the Repayment Plan and determine whether or not the parties agree to implement any proposal. If the parties agree a proposal, then they must each use best endeavours to implement that proposal.”

However it also said that:

"Unless otherwise provided for in a Finance Document, if the Lender has the discretion to require or determine something, consent to something, or act in a certain way under a Finance Document, that discretion is unfettered and absolute. It may be exercised without obligation, despite any previous waiver and in addition to any other rights and remedies conferred by the Finance Document or by law. Any determination made by the Lender will be in the Lender’s sole and absolute

31 Supra at [92]
32 [2013] NSWSC 1929
33 Supra at [23]
discretion and will (sic) conclusive and binding, except in the case of obvious error”

The loan agreement also contained a material adverse change clause which was relied upon as an event of default by AM Lancewood to assert a breach of the loan agreement enabling it to exercise its rights and demand immediate repayment of all monies owing to it pursuant to an acceleration clause contained in the loan agreement.

In this case the failure of the joint venture to meet its financial budgets due to a downturn in the market arising as a result of a reduction in mining development arising out of the global financial crisis, caused the Lender to form a view that this amounted to a material adverse change (being a default under the loan agreement). No default of payment had occurred under the terms of the loan agreement as the repayment of the principal was not to occur for 3 years.

Minumbra alleged that AM Lancewood was required to act in good faith in forming an opinion as to the occurrence of a material adverse change event prior to exercising their rights under that clause.

(b) Court Findings

The Court examined the material adverse change that the Lender had relied upon to assert a breach under the loan agreement and considered that where the Lender had acted “honestly and not capriciously and not in a manner that no reasonable lender would act” then the Lender was entitled to exercise its rights under the loan agreement.

Minumbra’s claim was dismissed.

(c) Points to take away from case

The Court rejected Minumbra’s submissions that by reason of the terms of the loan agreement itself or the terms of any other transaction documents, or the underlying intention of the joint venture, the Lender was not entitled to exercise all of its rights under the loan agreement in accordance with its ordinary meaning.

The Court stated that: “The requirement in clause 9.1(b) that the Lender engage in discussions with the Borrower does not have the effect that the Lender is not

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34 Supra at [13].
35 Supra at [226].
36 Supra at [149].
entitled to act in its own interests in deciding to serve a notice of default, if the discussion with the Borrower does not bear fruit. That is expressly recognised by the wording of the clause.\textsuperscript{37}

5. IMPLICATION OF TERMS

5.1 Issues with implication

Where a court is asked to imply a term of good faith into a contract differences have arisen amongst the Australian intermediate appellant courts as to:

(a) whether it is appropriate to imply ‘good faith’ into commercial contracts; and

(b) the test a court must apply to determine if a term should be implied into the parties bargain.

5.2 Implication in fact

Priestley JA stated in Renard Constructions (ME) Pty Ltd v Minister for Public Works\textsuperscript{38} (Renard):

“the so called implication in fact is really implication by judge based on the judge’s view of the actual intention of the parties drawn from the surrounding circumstances of the particular contract, its language, and its purposes, as they emerge from the language and in the circumstances.”

The test for implication of good faith as a matter of fact is contained in BP Refinery (Westernport) Pty Ltd v Shire of Hastings\textsuperscript{39} for formal contracts\textsuperscript{40} which stipulates that for a term to be implied:

“(1) it must be reasonable and equitable;

(2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;

(3) it must be so obvious it goes without saying;

(4) it must be capable of clear expression; and

(5) it must not contradict any express term of the contract.”\textsuperscript{41}

\textsuperscript{37} Supra n [154].

\textsuperscript{38} (1992) 26 NSWLR 234 at 255-256.

\textsuperscript{39} (1997) 180 CLR 266

\textsuperscript{40} These criteria do not apply exhaustively in the case of an informal contract. Hospital Products Ltd v United States Surgical Corporation [1984] HCA 64 as approved in Byrne v Australian Airlines Ltd [1995] HCA 24.
5.3 Implication by law

Priestly JA also in Renard stated that terms implied by law are:

“…based on imputed intention as opposed to actual intention, and [imply] a term as a legal incident of a particular class of contract”.

This requires an identifiable class of contractual relationship. Examples where specific terms have been implied as a matter of law into contracts of a certain class include: employer/employee, contracts for the sale of goods, landlord / tenant and contracts for carriage by sea. The classes of contract however have been stated not to be closed.

The test for implication of good faith as a matter of law is expounded in Burger King Corporation v Hungry Jack’s Pty Ltd which stipulates that a term will be implied in law in a particular class of contract if it is reasonable and necessary for that category of contract.

6. JURISDICTIONAL APPROACHES TO IMPLICATION

6.1 General analysis

Contrasting judicial consideration, due to the differing doctrinal bases of development of good faith and openness of definition, has lead to divergent views on implication of good faith into commercial contracts and a variety of judicial opinions as to the appropriateness or otherwise of the implication of good faith and if so, in what circumstances.

The intermediate appellate courts in New South Wales and Victoria have been the two predominant proponents for the divergent views which have emerged.

The resultant effect, in light of the High Court’s decision of Farah Construction Pty Ltd v Say-Dee Pty Ltd, is that two of the eight intermediate appellant courts in Australia have established different substantive bodies of precedent case law on whether and when good faith is to be implied into commercial contracts and the test required to be met to
determine good faith’s implication resulting in differing application in cases brought before the respective courts.

6.2 New South Wales

The New South Wales Court of Appeal has largely determined the approach to be taken as whether a good faith provision should be implied as a matter of law.\(^{52}\)

New South Wales courts have:

(a) implied terms of good faith into commercial contracts to require parties to disclose information, provide opportunities to alter courses of conduct and support to the objects of a contract;\(^{53}\)

(b) held “as a matter of general principle, the law of NSW implies an obligation of good faith into a contract”;\(^{54}\)

(c) found breaches of ‘utmost good faith’ to exist but determined that this was not fundamental term of a contract and therefore did not justify termination of the contract merely in the form of damages;\(^{55}\)

(d) held, where the law of Victoria was the governing law of the contract, that: commercial contracts are not a class of contract that as a legal incident have implied obligations of good faith and it will depend upon the individual contract as to whether good faith is implied with such term needing to meet the test laid down in BP Refinery;\(^{56}\)

(e) found that an express provision for the parties to terminate on the giving of 45 days notice meant that there was no justification for implying a term of good faith as submitted as the express term permitted termination on the party exercising the right having a reason to do so;\(^{57}\)

(f) held that a long line of decisions had established that an obligation to act in good faith could be implied in contractual agreements, this obligation did not require the party to act in the interest of the other party or subordinate its own legitimate


\(^{53}\) Supra n. 6.

\(^{54}\) Sundararajah v Teachers Federal Health Ltd [2009] NSWSC 1443 at [31]; Vodafone Pacific Ltd v Mobile Innovations Ltd [2004] NSWCA 15; The New South Wales Court found an obligation of good faith was implied as a matter of law in commercial contracts. However, Giles JA noted that it should not be implied into all commercial contracts referring to the “width and indeterminacy” of such a class.

\(^{55}\) Ibid.

\(^{56}\) Starlink International Group Pty Ltd v Coles Supermarket Australia Pty Ltd [2011] NSWSC 1154

\(^{57}\) Androvitsaneas v Members First Broker Network Pty Ltd [2013] VSCA 212 at [108].
interests but such term does require a party however to have due regard to the rights and interests of the other party.\(^\text{59}\);

(g) found that there was no breach of an implied obligation to act in good faith as “an obligation to act in good faith does not extend to being required to agree to something other than actual performance of the contract”.\(^\text{60}\);

(h) noted in obiter that “if…the obligation of good faith is intended to promote the enforcement of contracts, its use to prevent the exercise of a contractual right which on any view had arisen is hard to justify unless it can be said that the right was being exercised for a capricious or ulterior motive”.\(^\text{61}\)

6.3 Victoria

The Victorian Court of Appeal has:

(a) indicated that the preferred approach as to whether a duty of good faith should be implied is for implication to be as a result of a matter of fact, with there being no general implication of good faith into commercial contracts.\(^\text{62}\);

(b) in obiter the Court noted that a contractual duty of good faith may arise when there is a need to protect vulnerable people from exploitation. Warren CJ at [3]-[4] stated:

“If a duty of good faith exists, it really means that there is a standard of contractual conduct that should be met. The difficulty is that the standard is nebulous. Therefore, the current reticence attending the application and recognition of a duty of good faith probably lies as much with the vagueness and imprecision inherent in defining commercial liability…..Ultimately, the interest of certainty in contractual activity should be interfered with only when the relationship between the parties is unbalanced and one party is at a substantial disadvantage, or is particularly vulnerable in the prevailing context. Where commercial leviathans are contractually engaged, it is difficult to see that a duty of good faith will arise, leaving aside duties that might arise in a fiduciary duty.”

(c) stated if there is an implied obligation of good faith and fair dealing in credit arrangements not to exercise legal rights for an improper purpose, it certainly

\(^{59}\) Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd [2012] NSWCA 184

\(^{60}\) Ibid at [146] and [154].

\(^{61}\) AMC Commercial Cleaning (NSW) Pty Ltd v Coade [2011] NSWSC 932 at [133-134].

\(^{62}\) See Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL [2005] VSCA 228; Specialist Diagnostic Services Pty Ltd (formerly Symbion Pathology Pty Ltd) v Healthscope Pty Ltd & Ors [2012] VSCA 175.

\(^{63}\) Arnaghelschi & Anor v Ussher & Ors (2013) 94 ACSR 86

\(^{64}\) [2005] VSCA 228
would not have operated so as to restrict decision and actions reasonably taken to promote legitimate interests as expressed in the credit arrangements; 

(d) held where the parties submitted the test for implication of terms was the **BP Refinery** test that there was no basis for implying a term of good faith into a franchise agreement in relation to purchase of assets after termination as it did not appear the intention of the parties or appear to be required to give business efficacy to the franchise agreement to so imply a term of good faith.

### 6.4 Queensland

Queensland courts have historically been reluctant to recognise an overriding duty of good faith that binds parties in contractual relationships, however trial judges at first instance:

(a) adopted the observations in **Macquarie Health** as to the content of good faith;

(b) found that conduct of a party in promoting a development proposal was in breach of an express term to act in good faith under a contract to act in the best interests of a joint venture;

(c) noted the uncertainty of the law concerning the implication of good faith into commercial contracts but proceeded on the assumption that there was an implied duty of good faith when addressing a pleading which relied on the various authorities in New South Wales to support such an implication. Ultimately the case does not resolve the implication issue as the trial judge found that even if there was a duty to act in good faith it had not been breached.

### 6.5 South Australia

South Australian courts have largely adopted the New South Wales position with:

(a) a trial judge stating …"I consider that it is a term to be implied in every commercial contract, despite doubt expressed by some earlier cases that it was not to be implied unequivocally as a universal term. …however even if the term were not to

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66 Bytan Pty Ltd v BB Australia Pty Ltd [2012] VSCA 233 at [41 – 48]. See also Arhanghelschi & Anor v Ussher & Ors (2013) 94 ACSR 86 which affirms that in Victoria **Esso Australia** is the leading authority. The exercise of the relevant contractual power in this case was found not to attract an implied duty of good faith.

67 See Re Zurich Australian Insurance Limited [1999] 2 Qd R 203; Witham & Anor v Hough & Anor [2009] QSC 101 and Aquila Coal Pty Ltd v Bowen Central Coal Pty Ltd [2011] QSC 284; See also Kosho Pty Ltd v Trilogy Funds Management Ltd [2013] QSC 135 in which Applegarth J considered a pleading which relied on the various authorities in New South Wales to support the implication of the term. His Honour noted the uncertainty of the law concerning the implication of good faith into commercial contracts and proceeds on the assumption that there was an implied duty of good faith. The implication issue does not get resolved, however, as his Honour finds that even if there was a duty to act in good faith it had not been breached.

68 Ibid.

69 Kosho Pty Ltd v Trilogy Funds Management Pty Ltd [2013] QSC 135
be implied universally, this contract is one example of the type of contract where it must be implied\(^{71}\);

(b) obiter stating “where there is an implied term requiring the exercise of powers in good faith and/or reasonably in contracts involving an ongoing relationship between the parties (such as...franchise agreements...) a term may be implied that a contractual power to terminate must not be exercised arbitrarily, capriciously or unreasonably”\(^{72}\).

6.6 Tasmania

The Tasmanian Court of Appeal appears to have adopted a similar approach to Victoria\(^{73}\).

6.7 Western Australia

The Western Australia Court of Appeal and trial courts have:

(a) noted the “necessity for implication of a duty of good faith in the context of commercial contracts, both in performing obligations and exercising rights, has not been accepted universally in Australia”\(^{74}\),

(b) assumed that the New South Wales Court of Appeal case law authority for the proposition that a duty of good faith may be implied both in performing obligations and exercising rights may be imposed on parties to a contract\(^{75}\);

(c) determined that a duty of good faith in exercising termination rights should not be imposed on the parties as whilst the parties may be under a duty to co-operate this does not rise above the promises made by the parties in the contract\(^{76}\);

(d) found that a franchisor by having doubtful foundations for exercising a right to terminate, acting capriciously and unreasonably and also failing to recognise and have due regard to the legitimate interests of both parties that a breach of the express term of good faith in the franchise agreement had occurred\(^{77}\).

6.8 Federal Court of Australia

The Federal Court of Australia has:

\(^{71}\) Alstom Ltd v Yokogawa Australia Pty Ltd & Anor (No. 7) [2012] SASC 49

\(^{72}\) Highfield Property Investments Pty Ltd v Commercial & Residential Developments (SA) Pty Ltd [2012] SASC 165.

\(^{73}\) Tote Tasmania Pty Ltd v Garrott [2008] TASSC 86; Driveforce Pty Ltd v Gunns Ltd (No. 3) [2010] TASSC 38.

\(^{74}\) Trans Petroleum (Australia) Pty Ltd v White Gum Petroleum Pty Ltd [2012] WASCA 165.

\(^{75}\) Ibid at [150].

\(^{76}\) Ibid at [156].

\(^{77}\) Auto Masters Australia Pty Ltd v Bruness Pty Ltd [2002] WASC 286 at [388-393].
(a) considered whether as a matter of law that a duty of good faith and reasonableness can never be breaches by the exercise of some contractual right or forbearance from taking some action under a contract and rejected this formulation instead noting that it was a general rule that the parties are required to do all things necessary to have the benefit of the contract which lies under the good faith term78;

(b) noted that the matters raised surrounding good faith “invite a consideration of aims and purposes of the contract which task is properly to be seen as a matter for trial”79; and more recently,

(c) agreed with the parties submissions that as a matter of law there was an implied term of good faith which obliged “each party to exercise their powers conferred on it under those agreements in good faith and reasonably, and not capriciously or for some extraneous purpose”80.

7. CASE EXAMPLES OF ATTEMPTS TO IMPLICATE A GOOD FAITH TERM

7.1 Alstom Ltd v Yokogawa Australia Pty Ltd & Anor (No 7)81

(a) Facts

The case involved a refurbishment and automation of a power station in South Australia. The power station owners, Flinders Power Partnership (FPP), entered into a contract with the head contractor Alstom Power Limited (Alstom) worth $148.5 million.

Alstom subsequently entered into a joint venture with Yokogawa Australia Pty Ltd and Downer EDI Engineering Pty Ltd (YDRML) which incorporated the terms of the head agreement and provisions that were expressed to take precedence over the head contract.

Delays occurred and Alstom was required to pay FPP compensation.

Alstom then commenced proceedings against YDRML claiming that they were responsible for the delay.

YDRML counterclaimed on the basis that Alstom had breached their contract by failing to provide certain information. YDRML claimed failure to provide the

78 Oliver v Commonwealth Bank of Australia [2011] FCA 1440
79 Ibid.
80 RPR Maintenance Pty Ltd v Marmax Investments Pty Ltd [2014] FCA 409.
81 [2012] SASC 49.
information breached implied obligations to act in good faith, to co-operate and to provide information about the head contract works.

(b) Court Findings

All commercial contracts contain an implied duty to co-operate. This requires parties to do all that is necessary to enable the other to have the benefit of the contract. This rule is subject to express terms to the contrary. Alstom should have provided YDRML with regular updates and electronic copies of its works programs which could have then been implemented into YDRML’s programs.

All commercial contracts contain an implied obligation not to prevent or hinder performance. Generally, this duty is implied when one party’s ability to perform depends on the other not preventing performance. This is subject to express provisions.

All commercial contracts contain an obligation to act in good faith.

As a result of the principles found by the court as set out above, it was held that YDRML was unable to meet its obligations under the subcontract since Alstom failed to notify them of key dates and provide constant updates despite being asked on a number of occasions. This case demonstrates the fundamental duty to provide adequate information to the other party to avoid a breach of the duty to co-operate and not hinder completion.

(c) Points to take away from the case

This case takes a strong position that good faith is to be implied in all commercial contracts, despite doubts by other courts concerning indeterminacy and conflict with the pursuit of legitimate commercial interests.

In his judgment, Justice Bleby said that;

“I consider that [good faith] is a term to be implied in every commercial contract, despite doubts expressed in some earlier cases that it was to be implied unequivocally as a universal term.”82

Whilst parties should be aware that they have duties of co-operation and non-prevention to give effect to the bargain struck, this South Australian first instance decision also states a duty of good faith is also necessarily implied into their contracts.

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82 At [596]
Whether Justice Bleby equates good faith with co-operation and not hindering or as appears something more due to the separate statement of implication of good faith, the central core of what this means in situations other than the facts of this case again await clarification by the Courts.

7.2  **Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd**

(a)  **Facts**

Cordon was a property developer and commercial builder, while the second and third appellants were directors of Cordon.

Cordon and Lesdor Properties Pty Ltd (Lesdor), entered into a joint venture which was set out in a Deed of Agreement.

There were several grounds relied upon in this appeal however, for the purpose of this paper, grounds 15-18 will only be considered.

Under grounds 15-18, Cordon and its directors contended that the primary judge had erred in failing to hold that Lesdor had breached an implied obligation of good faith by adopting a strategy aimed at thwarting Cordon’s right to the benefit of the Residual Lots.

(b)  **Courts findings**

In relation to grounds 15-18, the primary judge gave little consideration as to whether an obligation of good faith was implied into the agreement because he held that the breaches could not be made out regardless.

On appeal, Bathurst CJ stated that while a long line of decisions had established that an obligation to act in good faith could be implied in contractual agreements, this obligation did not require the party to act in the interest of the other party or subordinate its own legitimate interests.

The Court held that Lesdor had not breached the implied obligation to act in good faith.

The Court noted that, ‘the fact [Lesdor] devised a strategy to deal with Cordon’s position was neither unreasonable nor dishonest, nor did it demonstrate a lack of fidelity to the Agreement’. Grounds 15-18 of the appeal failed.

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(c) Points to take away from the case

This decision highlights that, for a breach to occur, a party’s actions must be unreasonable, dishonest or demonstrate a lack of fidelity to the Agreement.

Whether a party’s actions can be characterised this way, is determined on a case by case basis.

This case also draws attention to the court’s hesitancy to imply that the obligation of good faith is paramount, especially when it conflicts with the legitimate pursuit of commercial interests.

7.3 Starlink International Group Pty Ltd v Coles Supermarket Australia Pty Ltd[^]

(a) Facts

Starlink International Group Pty Ltd (Starlink) provided trolley collection services to Coles Supermarkets Australia Pty Ltd (Coles) and Kmart Australia Ltd (Kmart).

The dispute arose due to Coles terminating the contract with Starlink on the basis of continued underperformance by Starlink and allegations that Starlink engaged in illegal conduct.

Starlink argued that Coles was not entitled to terminate the contract without informing Starlink of its reasons for doing so or giving Starlink a reasonable opportunity to rectify its conduct.

The express wording of the termination clause entitled Coles to terminate the contract ‘at any time without a reason’ and held that the only prerequisite that the clause imposed on Coles was to provide 45 days written notice to Starlink.

Starlink claimed that the Agreement between the parties included an implied term that Coles would act in good faith towards Starlink in terminating their contract.

Starlink submitted that the duty to act in good faith is implied as a matter of law into the Agreement.

(b) Courts findings

The Court found that commercial contracts are not a class of contract that, as a legal incident, have an implied obligation of good faith and it will depend on the

individual contract as to whether good faith is implied as was outlined in *Insight Oceania Pty Ltd v Philips Electronics Australia Ltd.*

The Court dismissed the claim by Starlink that an implied duty to act in good faith in exercising the right to terminate should be implied into the contract, as doing so would impose a condition on Coles inconsistent with the express term of the contract.

(c) **Points to take away from case**

This case recognises that an implied duty of good faith in commercial contracts may be imposed, but only in certain circumstances.

The Courts will be unlikely to find an implied duty of good faith where it is inconsistent with the expressed terms of a contract.

This case also highlights that the Courts strive to ensure certainty of contract and to uphold the terms to which parties have agreed.

The repercussion of this is parties should not rely on the exercise of judicial discretion as a matter of course to imply good faith into a contract and that an approach that delivers more certainty (albeit not absolute certainty) is to draft express terms, as the Court’s will endeavour to uphold expressed contractual terms, even if the effect of doing so may produce arguably unfair results.

7.4 *Beerens v Bluescope Distribution Pty Ltd*\(^86\)

(a) **Facts**

Bluescope distribution Pty Ltd (*Bluescope*) and Griffiths and Beerens Pty Ltd (*Company*) were in a supply agreement where by Bluescope would supply steel products to the Company through informal and formal credit arrangements.

A winding up application was brought against the Company by an unrelated party which resulted in Bluescope stopping supplies until Mr Beerens, who was a director of the Company, gave Bluescope a personal guarantee for the due and punctual payment of all debts and monetary liabilities of the Company to Bluescope and an indemnity from any loss suffered in relations to the non payment of those debts or monetary liabilities.

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\(^{85}\) [2008] NSWSC 710  
\(^{86}\) [2012] VSCA 209.
Subsequently the Company was placed into receivership and was wound up in insolvency as a result of an application by the Deputy Commissioner of Taxation.

Due to this, Bluescope relied on a clause in the formal credit agreement to refuse to extend further credit, and to demand immediate payment of all moneys due.

Bluescope also brought proceedings for damages against Mr Beerens to enforce the Guarantee and Indemnities.

Mr Beerens argued that his personal guarantee was unenforceable as it had been obtained by use of illegitimate pressure amounting to economic duress. This argument was based on three related but separate claims being unconscionable conduct, breach of contractual obligations of good faith and knowingly assisting the breach of a fiduciary duty.

For the purpose of this paper the submissions in relation to good faith only will be addressed.

(b) Court findings

The Court observed that an implied term ought not to be inconsistent with, or contradicted by, the express terms of a contract.

BlueScope emphasised the express terms of the credit agreement, which clearly permitted it to withdraw credit facilities and demand immediate payment in the event that a receiver or similar official was appointed over any of the assets of the company or the company was presumed to be insolvent.

Based on this, an implied duty to act in good faith and not withdraw credit facilities in light of insolvency would be inconsistent with the expressed terms of the credit agreement.

Bluescope’s decision to withdraw credit was found not to be unreasonable in a situation of the Company going insolvent.

(c) Points to take away from this case

This case shows that some Courts are unwilling to find an implied provision of good faith where it would be contradictory with any expressed contractual terms.

Based on this, contracting parties should take care when drafting contracts to include expressed ‘good faith’ provisions to identify the scope of their application
and ensure other applications are not excluded through a narrowly expressed treatment, if that is the intention sought.

7.5 **Trans Petroleum (Australia) Pty Ltd v White Gum Petroleum Pty Ltd**\(^7\)

(a) **Facts**

Trans Petroleum (Australia) Pty Ltd (TP) was the owner of land upon which was located a service station and a convenience store. White Gum Petroleum Pty Ltd (White Gum) was the licensor of the Peak system for the operation of convenience store businesses from service station sites.

Pursuant to a Lease Peak leases the land from TP. Pursuant to a Fuel Re-Selling Agreement, White Gum granted to TP a non-exclusive licence to operate a convenience store from the land using the Peak system.

After 2 years White Gum issued a termination notice of the Fuel Re-Selling Agreement to TP.

Proceedings were commenced with TP alleging amongst other submissions:

- the termination clause is ambiguous when read in context of other clauses and the agreement as a whole;
- the power of termination must be exercised in good faith;
- the requirement that the power of termination be exercised in good faith arises upon a proper construction of the agreement as a whole or alternatively is implied by law...\(^8\)

White Gum submitted that the power of termination was not limited in the manner argued by TP.

(b) **Court findings**

The Western Australia Court of Appeal stated that:

- The Court of Appeal of New South Wales has decided numerous cases that a duty of good faith, both in performing obligations and exercising rights, may by implication be imposed on the parties to a contract.\(^9\)
- However the necessity for the implication of a duty of good faith in the context of

\(^7\) [2012] WASCA 165.
\(^8\) Ibid at [132].
\(^9\) Ibid at [150].
commercial contracts, both in performing obligations and exercising rights, has not been accepted universally within Australia.\(^\text{90}\)

- **I will assume…**that the line of authority in New South Wales reflects the law in Australia; it is unnecessary, in this appeal, to decide the point. … An implied obligation of the kind sanctioned in the New South Wales cases, does not extend to the imposition of obligations on the parties to a contract that are, in effect, inconsistent with the terms of the bargain.\(^\text{91}\)

- **In my [[Buss J with whom Pullin and Murphy JJ concurred] opinion, a duty of good faith, in exercising termination rights, should not by implication be imposed on the parties. The implication would be inconsistent with the terms of the bargain agreed upon by the parties.**\(^\text{92}\)

- **The parties to a contract may be under an implied duty to co-operate in the performance of contractual obligations**… However, **this duty does not rise above the promises made by the parties to the contract.**\(^\text{93}\)

(c) **Points to take away from this case**

The Court found there was no basis to overturn the decision at first instance on the grounds pleaded relating to implying a term of good faith.

8. **LEGISLATED GOOD FAITH**

Finally in some instances ‘good faith’ has been either legislated into existence or legislated to apply in certain areas.

Provisions in for example, the *Competition and Consumer Act 2010* (Cth)\(^\text{94}\), the State and Territory equivalent Acts, the *Uniform Civil Procedure Rules 1999 (Qld)*\(^\text{95}\) introduce concepts of good or bad faith, without defining the term, leaving it to the common law to supply the content to give effect to the legislative provisions.

Other legislation such as the *Fair Work Act 2009* (Cth)\(^\text{96}\) specifically outlines what is considered to be good faith in the context of the obligations under that Act.

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\(^{90}\) Ibid at [151].

\(^{91}\) Ibid at [152 and 154].

\(^{92}\) Ibid at [155].

\(^{93}\) Ibid at [156].

\(^{94}\) See for example section 44F – where good faith is a factor to be considered in determining if a service is to be declared, section 44LB and 44Y – where the commission may terminate arbitration if negotiations are not engaged in good faith.

\(^{95}\) See for example rules 247 – good faith being required to be considered by a judge in determining applications, rule 566 and 567 – bad faith needing to be included in pleadings.

\(^{96}\) See for example section 228 – which defines what good faith bargaining requirements are that must be met by bargaining representatives in the Fair Work Commission jurisdiction. See also sections 3, 153, 171, 460 of that Act.
In the context of franchising the *Trade Practices (Industry Codes – Franchising) Regulations 1998 (Franchising Code)* stipulates at section 23A that:

“Nothing in this code limits any obligation imposed by the common law, applicable in a State or Territory, on the parties to a franchise agreement to act in good faith.”

Notably on Wednesday 2 April 2014, the Commonwealth Minister for Small Business, the Hon Bruce Bilson MP, released:

(i) ‘Future of Franchising’ – a statement which outlines the government’s franchising policy reforms;

(ii) ‘Competition and Consumer Amendment Bill 2014 – Exposure Draft’; and


The Exposure Draft however incorporates a legislative obligation to act in good faith which is to apply to any dealing or dispute relating to a proposed franchise agreement, the negotiation of the proposed agreement and the requirements under the Code. The parties will be unable to exclude the obligation to act in good faith, in contrast to general contract law principles.

The definition in the Exposure Draft limits the meaning of good faith to that of a party acting honestly and not arbitrarily and to co-operate to achieve the purposes of the franchise agreement. Clause 7 also states that the obligation to act in good faith does not prevent a party from acting in his or her legitimate commercial interests.

The definition and the reiteration of ability to act in pursuit of legitimate commercial interests codify the uncontroversial and oft-reiterated features of good faith applied by the courts in common law actions.

Unfortunately differences in the common law about the scope and implication of good faith exist due to different development of the law around what constitutes good faith and when it should be considered to be part of a commercial contractual agreement.

The changes are indicated to take effect on 1 January 2015 (subject to any amendments as a result of the submissions made during the consultation period) and apply to all franchise agreement entered into or renewed after that date.
9. CHALLENGES IN DRAFTING

9.1 General comments

As a result of the number of decisions by intermediate appellate courts and courts of first instance a number of general drafting rules and principles can be said to exist. These include:

When drafting contracts, incorporation of broad terms imputing good faith can appear vague and will attract the exercise of judicial discretion. For example, if a contract contains a clause requiring both parties to merely agree on the appointment of a mediator, then any requirement to act in good faith to be considered is vague.

Justice Douglas suggests in relation to the above example it would be advisable to incorporate into the clause a list of objective standards to ensure the independence of the mediator. By specifying objective requirements, it is easier to later demonstrate to a Court that the parties have acted, or have not acted, in good faith.

The most important question a party needs to ask themselves when attempting to comply with an obligation of good faith is not whether an obligation has been imposed but instead whether they understand the content of the clause.

As such, it is imperative that parties ascertain the context and meaning of the words to the contract to establish their good faith obligations. Parties should apply an ordinary meaning to the words of the contracts and only depart from this method where it may be justified with reference to the context of the whole contract. This is because if a duty to act in good faith exists, it must accommodate the other terms of the contract.

The Courts cannot imply a duty of good faith if that duty is inconsistent with the express language contained within the contract. However, professionals should
also be wary when drafting express obligations as it may make it difficult to imply some other obligation.\footnote{Ibid.}

\textit{Vodafone Pacific Ltd v Mobile Innovations Ltd}, found it is possible to exclude, as far as the law permits, any implied terms from a contract.\footnote{Ibid.} For example, a contract may state that ‘any implied obligations of good faith or reasonableness’ be excluded.\footnote{Molino Cahill Lawyers, \textit{Implied Duty of Good Faith: The Fetter on Powers under Australian Construction Contracts} (2008) \texttt{<www.molinocahill.com.au/LiteratureRetrieve.aspx?ID=73882>} at 5 November.} If no express exclusion clause is made in the contract, the courts will determine the existence of good faith with reference to all the other clauses to the contract.\footnote{Robert McDougall J, ‘The implied duty of good faith in Australian contract law’ (2006) 108 \textit{Australian Construction Law Newsletter} 28.} Realistically however it would be highly unlikely that when contracting with another party that a clause specifically excluding good faith performance of obligations or rights held would be included.

\textit{Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd}\footnote{[2003] HCA 10.} saw Justice Templeman find that the right to terminate is not required to be exercised reasonably simply because there is an express contractual obligation requiring the parties to act in good faith. The Court held that an obligation to act in good faith does not prevent the parties from pursuing their own legitimate commercial interests, even if those interests result in termination of the contract.\footnote{Implied Duty of Good Faith: A Fetter on Powers under Australian Construction Contracts, Molino Cahill Lawyers.}

\section*{9.2 Options when drafting which will impact on enforcement}

Professor Horrigan helpfully sets out options available to drafters of commercial contracts when considering how to address good faith when formulating the terms of the contract.

These include:

(a) make no reference and then seek to imply good faith later relying on the exercise of judicial discretion using the \textit{Renard} line of authorities;

(b) incorporate an undefined and general obligation of good faith on all parties and run the risk of such a clause being found void for uncertainty of term again due to the reliance on judicial discretion to provide meaning to the term;

(c) incorporate and define good faith with narrow application to parts only of a commercial contract, permitting the application of good faith to the strict contractual
agreement of the parties and potentially excluding the application of a general term of good faith to the balance of the contract;

(d) exclude any implied obligations of good faith as far as possible under law and argue that this clause prevents the reading into a commercial contract any implied term of good faith; or

(e) choose a governing law of a jurisdiction that either routinely implies good faith into commercial contracts, such as New South Wales, or is more circumspect in determining whether good faith is a feature of a particular commercial contract.

As a litigator the approach adopted by the drafter, whether consciously or not, will offer options as to how arguments can be formulated in Court when seeking either to enforce or terminate commercial contracts.

In addition should the proposed legislative changes to the Franchising Code be made law unamended from the Exposure Drafts circulated then those dealing with franchising agreements will need to be conscious of the ‘frozen’ meaning of good faith as defined in the Exposure Draft. This is likely to increase the uncertainty between the extent, application and enforcement of good faith at common law as will be distinct from case law that will no doubt develop pursuant to the application of the newly proscribed ‘good faith’ definition in the Code.

This is likely to see adopted in dispute resolution and litigation situations (particularly in those jurisdictions which have case law that expresses a more expanded definition of ‘good faith’ than that which appears in the Code) alternate claims to breach of good faith both under the legislative provisions of the Code/Act and at common law thus likely to lengthen resolution or determination of such disputes.

10. CONCLUSION

In practice however due to the varying approaches and lack of certainty, the approach to good faith in commercial contracts, and by default franchising, remains unclear and adhoc. Confusion continues to exist as to the extent of good faith, its interaction with unconscionability, fair dealing and reasonableness, and more broadly protection of the vulnerable under Australian laws112. This uncertainty lends itself to generally either:

(a) Express incorporation of ‘good faith’ into franchise agreements and either a determination to define for the purposes of the franchise agreement what this

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112 Such as has occurred with the introduction of the Australian Consumer Law.
means or a reliance on the case law developed to date based upon the choice of law set out in the franchise agreement as the governing law of the contract; or

(b) the absence of reference to good faith in franchise agreements and an attempt on the breakdown of the relationship and the instituting of litigation of an implied term of good faith as an additional contractual breach of contract claim often in conjunction with other causes of action.

Notably there is no obvious trend to expressly exclude the application of good faith to commercial contracts, despite case law finding that an entire agreement clause was insufficient to exclude the implication of a term of good faith into a commercial contract113.

The current uncertain status of ‘good faith’ is expected to continue so due to the divergence that has emerged until either High Court pronouncement or reconsideration by the State intermediate courts of appeal which leads to a consistent cohesive line of authority in all States of Australia.

In the interim drafters of franchise agreements, and litigators of franchise agreement terms, continue to grapple and case by case add definition and substance to what is accepted as ‘good faith’ and when it is applied in commercial contractual relationships such as franchises.