

# ***THE OBLIGATION OF GOOD FAITH IN COMMERCIAL CONTRACTS***

*2<sup>nd</sup> Annual Sydney Commercial Law Masterclass*  
Television Education Network

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# OUTLINE

The topics I will cover off will include:

- (i) what is the current principle of good faith in Australian contract law?
- (ii) can good faith as a contractual term be imputed or implied?
- (iii) is an express term of good faith enforceable?
- (iv) is reasonableness a part of the concept of good faith?
- (v) binding terms/drafting considerations and tips
- (vii) recent cases and developments

# THE MAIN TAKEAWAYS: the focus is on powers and obligations

As things stand in Australia, when one speaks of good faith in the law of contract, one is not necessarily talking about some roving freestanding principle that applies all contracts in some diffuse way.

One is speaking about articulating:

- (i) restraints over the manner in which one party may exercise contractual rights and powers; &
- (ii) the manner in which obligations are performed.

# THE MAIN TAKEAWAYS: the focus is on powers and obligations

Courts at trial and intermediate appellate level still grapple with whether

(i) the obligation of parties to a contract to act reasonably and in good faith , should be viewed as an incident of *all* commercial agreements; or

(ii) that position can only be arrived at by way of terms implied either *ad hoc* (i.e. as a matter of fact on the basis of *BP Refineries & Codelfa* reasoning); or perhaps

(iii) whether such a term is implied *de jure* ( i.e. as a matter of law) in all commercial contracts of a particular class.

# THE LATEST INTERMEDIATE COURT JUDGMENT

The latest intermediate appellate court judgement which has addressed the matter directly as opposed the QCA in 2020 in *Glencore /Aurizon*.

*The QCA upheld the primary judge in that regard*

Their Honours eschewed an approach of a generalised duty of good faith in all commercial contracts but nevertheless on the unusual facts of the case, found a duty *ad hoc*.

# RECENT SUPREME COURT JUDGMENTS

## Check for appeals including special leave applications

- *Westgem Investments No 6* [2020] WASC
- Do an austlii search on “*Aurizon and Glencore*” now that the QCA has spoken in late 2020
- Check for any appeals including special applications – the cases going to trial involve significant contracts, with large sums involved

# ***RENARD v THE MINISTER***

*Renard v The Minister for Public Works* (1992) involved a building contract on a standard form, under which the principal had the right to call upon the builder to show cause why the contract should not be terminated & entitled the builder to respond by providing information to stave off being terminated. In those circumstances, the NSWCA held the principal had to act reasonably at *both* of those stages, namely when the superintendent issued the show cause notice and secondly when the superintendent considered any information that the builder chose to provide; otherwise a *trivial breach would allow termination of valuable rights* .

**NOTE** emphasis on the context and *differing approaches of the judges* (via variously construction of contracts and implication ). At least one judge said minds could differ on the *Codelfa* aspects.

# A LITTLE BIT OF HISTORY

- The obligation to act in good faith, described in various ways, has been recognised for a considerable time .It has been established at least since the late 1800's that a party to a contract must do all things necessary to enable the other party to have the benefit of the contract: *Butt v McDonald* (1896) approved by the HCA in 1979 in *Secured Income Real Estate v St Martins Investments*.
- Equity's jurisdiction to restrain the unconscionable exercise of pretended legal rights also goes back to the 1800's . See cases like *Tanwar HC as read with Santom* [2002] FCA



# JUSTICE MCDOUGAL'S VIEW FROM NSW

- *“Speaking today, it is possible to say that the debate centres not so much on the existence of a duty of good faith in the performance of contractual obligations, but on a number of ancillary, although nonetheless important, questions. These include:*
  - *(1) Does the duty arise by implication or as a matter of construction?*
  - *(2) If the duty arises by implication, does it arise by implication in fact, implication in law or some other process?*
  - *(3) Is the duty universal, or an incident of particular contracts or classes of contract?*
  - *(4) To what extent may the duty be negated by express provision or necessary implication? ...”*

# THE HIGH COURT

- The High Court declined to decide the issue in 2002 in *Royal Botanic Gardens* (it was not necessary to do so).
- “The question whether a standard of good faith should be implied generally to contracts has not been resolved in Australia”: per Kiefel J in 2014 in *Commonwealth Bank of Australia v Barker* .

# THE FEDERAL COURT

- In 2015 and 2017, the Full Federal Court found in favour of an implied obligation of good faith in the context of *franchising* agreements, in the *Marmax Investments Pty Ltd and YUM! Restaurants cases*.
- This is unsurprising in light of the 2001 NSWCA decision in *Burger King v Hungry Jacks*. But note that case had no clear majority on why it was held that there was an obligation to act reasonably.

# CONTENT OF THE DUTY OF GOOD FAITH

## IS IT THE SAME REASONABLENESS?

- “ .... whole forests have been felled to produce judicial and academic writing on the meaning of good faith in contract law.”: per the Hon Marilyn Warren AC in the article referenced at the end.
- The duty of good faith can “play out” in different ways in different contexts, e.g.
- *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL (Receivers and Managers Appointed) (Administrators Appointed)* [2005] VSCA 228 at [29], the duty was described as follows:  
'is not a duty to prefer the interests of the other contracting party, but rather to have due regard to the interests of both parties and the benefits afforded by the contract'.

# CONTENT OF THE DUTY OF GOOD FAITH

## IS IT THE SAME REASONABLENESS?

- In *Renard*, Priestley JA thought that “good faith” was much the same as “reasonableness” (26 NSWLR at 258), and this was endorsed in *Alcatel* and *Burger King*.
- In 1998, in *Alcatel v Scarcella* the NSWCA opined that the “concept of good faith” encompassed 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; and
  - (3) compliance with standards of contract which are reasonable having regard to the interests of the parties.

## ***ALCATEL v SCARCELLA***

- In *Alcatel*, the NSWCA said that in New South Wales a duty of good faith, both in *performing obligation* and *exercising rights*, may be imposed upon parties as a legal incident of a commercial contract, by a process of implication.

## ***WHICH WAY ARE THE JUDICIAL WINDS BLOWING IN NEW SOUTH WALES IN 2021?***

***Though good faith said to be an inherently nebulous concept, NSW is holding the fort***

In *Gujarat NRE India* [2018] NSWSC, the hon Mr Justice Robb opined that “good faith” was an inherently nebulous concept.

## ***WHICH WAY ARE THE JUDICIAL WINDS BLOWING IN NEW SOUTH WALES IN 2021?***

The case was a commercial one, involving one party claiming as a guarantor to be indemnified in an amount of \$12 million.

See for example paragraph [221], where his honour endorsed the following observation from a previous case:

“Where...parties have engaged in a detailed exposition of their respective rights and obligations in a formal document, there may be less call, or scope, for a generic implied term of any description.”

But see *Bundanoon* 2019 NSWCA



# DIFFERENT FACTUAL SCENARIOS

- *Building and Construction Contracts*

*Renard v The Minister* (ibid)

- Reasoning a la *Renard* was applied in 2019 by the NSWCA in *Bundanoon Sandstone*

It was held that the show cause notice was issued for an improper purpose.

Notice—established category of case.

# DIFFERENT FACTUAL SCENARIOS

- *Landlord and Tenant*

*AMP v 400 St Kilda Rd* [1991] VicRp 80; [1991] 2 VR 417, 424-426 is authority for the proposition that where there is a term in the lease that the tenant must not assign it without the landlords consent, then absent any statutory restriction on the landlord withholding consent, the common law does not require the landlord to act reasonably in that regard.

# DIFFERENT FACTUAL SCENARIOS

- *Vendor and Purchaser*

A contract of sale of land that is subject to satisfactory finance impliedly obliges the buyer to consider an offer of finance either in good faith or in good faith and reasonably. And a contract of sale of land that is subject to a condition that the purchaser first sells their existing home impliedly requires that the purchaser's sale is made within a reasonable time.

# DIFFERENT FACTUAL SCENARIOS

- *Superficially bizarre game of musical chairs*

*Aurizon Network Pty Ltd v Glencore Coal Queensland Pty Ltd* [2019] QSC 163

Case regarding access to railway infrastructure/network by customers who operated mines.

- *Banking and finance*

e.g. *Westgem* [2020] WASC

# ***SOME OTHER CATEGORIES OF GOOD FAITH CASES CONSIDERED IN MY ACCOMPANYING PAPER***

- Strata by laws—fraud on a power / improper purpose : *Houghton v Immer*
- Commercial leases and bailment
- Where one party acts on a judicially determined right
- Best endeavours clauses
- Obligation to negotiate in good faith in e.g. building and engineering contracts:  
*e.g. United Group Rail* [2009] NSWCA – obligation held to have clear content by trial judge and upheld by NSWCA

# NEGATING GOOD FAITH IMPLICATIONS

- *Express words (because these negate implications via the common law , as opposed to some statutorily implied terms found e.g. in the ACL)*
- *Absolute discretion clause*
- *Entire agreement clause*

# ***DRAFTING TIPS / BINDING TERMS***

- Consider the category of case you are in e.g. building and construction, or franchising , or supply agreement or sales off the plan: pre-eminent types of cases where one party can issue notices on the other, terminating the contract and forfeiting valuable rights.

## ***Litmus test***

- Does the party you are representing wish the issue of any such notice to be subject to a restraint based on good faith? If you seek such wording, and the other party rejects that, then you need to consider very seriously whether that's a deal worth having.
- Consider the Court you may one day end up before: which State? Federal Court? etc and consider the approach you take to drafting in that light. BUT bear in mind it all may change on an appeal – so make sure to give *written advice* to your clients about that.

# ***DRAFTING TIPS***

- If you are representing the party who may wish, one day, to terminate for convenience or deny a request for convenience (e.g. in leasing cases, to not agree to a particular request) then consider the lexicon of *absolute or sole discretion / entire agreement/ like phrases*.
- If you think a good faith restraint (e.g. show cause notices) or obligation (e.g. to negotiate in good faith to say resolve disputes; or address unforeseen contractual circumstances in long term contracts in the resource or IT sector) may be found one day to be impugned on the basis its too vague / nebulous, then consider having a severability clause; or perhaps a stepped type of clause where if one sub-para is severed, the rest is still good.



# ***YOUR FEEDBACK & CRITIQUE WELCOMED***

- If you have any war stories to share, feedback or criticism you'd like to offer, please email:

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I'm particularly keen to hear from you as to drafting strategies