Good faith in (banking) contracts

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Introduction

The traditional adversarial model of contract in which each party is free under the law to pursue its own interests without regard to any detriment its actions may cause to the other party, is being eroded by a more cooperative model of contract whereby the parties' rights to pursue their own business interests are not unfettered.

The erosion of the traditional doctrine is taking place by both statutory innovation, for example the new Division VA of the *Trade Practices Act* (1979) (unconscionable conduct), the *Contracts Review Act* (1980) and by developments in the common law, for example the reformulation of estoppel as an overarching principle in *Waltons Stores (Interstate) v Maher* (1988) 164 CLR 387. More recently, increasing judicial and academic attention is being focused on the concept of good faith and its role in Australian contract law. Recent judicial discussion has examined the role of good faith in the context of precontractual negotiations and that of the performance of contractual obligations after agreement has been reached.

The concept of good faith is not novel to the law of contracts. For some time the law has recognised a certain category of commercial contract, contracts *uberrimae fidei* (the most perfect frankness) where the law imposes a duty of utmost good faith which involves the fullest disclosure of material facts to the other party. Contracts between lender and creditor or guarantor are not however contracts *urberrimae fidei; Beneficial Finance Corp Ltd v Karavas* (1991) 23 NSWLR 256 at 276.

Pre-contractual negotiations: a tortious duty to act in good faith

In *Gibson v Parkes District Hospital* (1991) 26 NSWLR 9, Badgery Parker J held that the parties to a contract in that particular case were under a tortious duty to act in good faith due to the special relationship that existed between them (and which therefore satisfied the requirements of proximity). He found that employees and workers' compensation insurers are under a duty to act in good faith in the processing of a workers' compensation claim, breach of which founds a tortious action for damages.

During his judgment he stated that:

"The common law has always shown itself capable of developing causes of action where justice so demands, whether by the creation of new torts or the extension of well established principles to new types of fact situation.... [N]ovelty is not of itself a barrier to a proposed claim." (1991) 26 NSWLR at 23.

The possibility that such a tortious duty may exist between a prospective financier and a customer in relation to the entry into a (new) financing transaction was however rejected by Giles J in the unreported case of *Westpac Banking Corporation v Bowden Westpac Banking Corporation v Kathlig Pty Ltd* (SC NSW 13 December 1993). His reasoning referred to the notions that it would be too great a departure from the established principles for commercial contracts, that other legal doctrines and Statutes are adequate to protect the interests of parties to contracts and finally that the notion of a duty of good faith is too imprecise and indeterminate.

Contracts to negotiate in good faith

Another approach to the issue of good faith in negotiation of contracts is to enter a preliminary contract to negotiate in good faith. A recent Australian Court of Appeal decision found that a preliminary contract to negotiate in good faith is enforceable: *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1, per Kirby P, with whom Waddell A JA agreed. Handley JA disagreed on this point.

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Performance of contractual obligations implied term to perform in good faith

Griffiths J in *Butt v McDonald* (1896) 7 Qld 68 at 70,71 stated that:

"It is a general rule applicable to every contract that each party agrees by implication, to do all such things as are necessary on his part to enable the other party to have the benefit the to contract."

This idea has recently received emphasis in various Australian judgments. In *United States Surgical Corp v Hospital Products International Pty Ltd* [1982] 2 NSWLR 766 at 799Ñ801, McLelland J in considering the implication of a term to carry out contractual obligations in good faith stated that such an implied obligation would appear not to demonstrate any material divergence from the law of New South Wales, and in substance probably represents the principle stated by the High Court of Australia in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 607 quoting the words of Griffith CJ in *Butt v*

McDonald (1896) 7 Qld 68 at 70,71.

The existence of the term was also supported by McLelland J's judgment in *United States Surgical Corp v Hospital Products International Pty Ltd* [1982] 2 NSWLR 766, Priestly J's judgment in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 and by Gummow J in *Service Station Association v Berg Bennett* (1993) 117 ALR 393 at 401-407.

In *Secured Income Real Estate,* supra, at 607 8, Mason J when discussing the implication of a term of good faith, made a distinction between acts which are essential to the performance by one or both parties of their contractual obligations and acts which are not. He stated that it is a general rule of construction that a term of good faith will be implied where it relates to acts which are necessary to the performance by one or both parties of their obligations or are fundamental obligations under the contract. With regard to acts however, which are necessary to entitle the other party to a benefit under the contract but are not essential to the party's obligations or fundamental to the contract, he stated that there is no general rule that a term of good faith will be implied and whether it is implied depends on the intention of the parties in the particular case (as manifested by the contract). Similarly, In *Service Station Assn v Berg Bennett,* Gummow J (at 409) stated that there is an implied term in contracts to *'do acts which [are] necessary for the performance by the parties, or by one of them of the fundamental obligations under the agreement.'* In addition he stated that this implied term is narrower than a general duty of good faith and fair dealing in the performance and enforcement of the contract which forms a part of the law in the United states but does not state the law in Australia. Although there are clear statements supporting the existence of the implied term, the proviso of McLelland J in *United States Surgical Corp v Hospital Products International Pty Ltd* [1982] 2 NSWLR 766 at 799 801 noting that his characterisation of the implied term was similar to that of Gummow J in *Service Station Assn* and Mason J in *Secured Income,* must be noted borne in remembered the implication of such a term would extend only to the performance of the express terms of the agreement and may not be used as a springboard for other implied terms.

The future

The diminution of the classic model of freedom of contract is taking place by way of numerous parliamentary innovations and judicial developments. It remains to be seen how much of the weight of the attempt to increase the flexibility of the law of contract will be borne by the notion of good faith and how much will be borne by other doctrines such as unconscionability, estoppel and reasonable expectations. The answer depends on which approach is taken to the notion of good faith; that of Giles J in *Kathlig,* (at p15) which is to de-emphasise the role of good faith so as to not create an overabundance of principles meriting the description of categories of indeterminate reference or that of Badgery-Parker J in *Gibson v Parkes District Hospital,* (at p23) where in reference to good faith he states that: *"The common law has always shown itself capable of developing new causes of action where justice so demands."* ■

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