Implied Obligations of Good Faith and Reasonableness in the Performance of Contracts: Old Wine in New Bottles?

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The current debate in the courts and the law reviews over the existence and content of an implied contractual obligation of good faith has tended to overshadow the role of more familiar methods of controlling contractual performance. This article explores the connection between the implied terms of good faith and co-operation and examines the extent to which the obligation of good faith adds to the obligation of co-operation, or to existing equitable principles controlling the exercise of contractual rights and powers. The recent Australian authorities are discussed, along with a brief examination of the role of good faith in foreign jurisdictions, particularly the United States.

A decade ago in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd*,[1] Gummow J considered the then nascent practice of pleading an implied term of good faith in the performance of contracts. His Honour observed that the origins of the term did not appear to differ from those of another implied term more familiar to Australian law, namely the implied obligation of co-operation.[2] His Honour nevertheless thought that to recognise an implied term of good faith in Australian law required a 'leap of faith'.[3] In the intervening years, Australian courts, particularly in New South Wales, have demonstrated a willingness to take that leap, holding that an obligation of good faith may arise as an incident of a commercial contract.[4]

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1. *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393.
2. Ibid, 405-406.
3. Ibid, 406.
4. The list of cases is growing rapidly: eg, *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1; *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703; *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187; *Central Exchange Ltd v Anaconda Nickel Ltd* (2002) 26 WAR 33; *Overlook v Foxtel* (2002) Aust Contract Reports 90-143; *Spira v Commonwealth Bank of Australia* (2003) 57 NSWLR 544; *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 (*Vodafone*); *Service Station v Berg Bennett* ibid; *GSA Group Ltd v Siebe Plc* (1993) 30 NSWLR 573.

This article explores the connection between the implied terms of good faith and co-operation adverted to by Gummow J,[5] and examines the extent to which the obligation of good faith adds to the obligation of co-operation, or to existing equitable principles controlling the exercise of contractual rights and powers. It is suggested that good faith adds little to these more familiar principles regulating contractual performance, and the current controversy[6] over the reception of good faith in Australia is perhaps less a 'burgeoning maelstrom'[7] and more a storm in a teacup.

Good faith is a chameleonic concept,[8] and prescriptions of good faith can be found in various statutory,[9] equitable and common law contexts.[10] However, this article is limited to a consideration of the implied obligation of good faith in the performance and enforcement of contracts. It is in this context that good faith prompts comparison with the obligation of co-operation, and in which good faith has attracted the greatest judicial attention in Australia.

In particular, two pivotal cases will be considered: *Renard Constructions (ME) Pty Ltd v Minister for Public Works,*[11] and *Burger King Corp v Hungry Jack's Pty Ltd*.[12] In the first, Priestley JA of the New South Wales Court of Appeal found that the respondent had breached an implied obligation to exercise contractual powers reasonably, a standard his Honour described by reference to good faith. In the second, the New South Wales Court of Appeal identified a number of breaches of the appellant's implied obligation to exercise its powers and discretions in good faith and reasonably.

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5. The potential overlap between these principles has also been noted by Barrett J in *Overlook v Foxtel* ibid, 91,970, and by commentators: IB Stewart 'Good Faith in Contractual Performance and in Negotiation' (1998) 72 ALJ 370, 370-373; E Peden 'Co-operation in English Contract Law – To Construe or Imply?' (2000) 16 JCL 56; J Carter & E Peden 'Good Faith in Australian Contract Law' (2003) 19 JCL 155.
6. Eg, P Finn 'Equity and Commercial Contracts: A Comment' [2001] AMPLA Yearbook 414; T Carlin 'The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25 UNSWLJ 99; Carter & Peden ibid.
7. LJ Priestley 'Contract – The "Burgeoning Maelstrom"' (1987) 1 CLJ 15. Priestley JA used the phrase 'burgeoning maelstrom' to describe the intensifying tussle between classical contract principles and developments such as good faith, unconscionability and estoppel.
8. EA Farnsworth 'Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code' (1963) 30 UCLR 666, 678, described it as a 'protean' concept.
9. In *Bropho v Human Rights & Equal Opportunities Commission* (2004) 204 ALR 761, 783, French J noted that 154 Commonwealth statutes use the phrase 'good faith'.
10. It has been argued that obligations of good faith are owed in relation to pre-contractual negotiations: eg, *Tobias v QDL Ltd* (unreported, NSW Sup Ct, 12 Sep 1997, Simos J), and also that an obligation of good faith can give rise to positive duties: see eg: *Overlook v Foxtel* above n 4; *Central Exchange v Anaconda Nickel* above n 4. As to which, see P Baron, R Carroll & A Freilich 'Implied Terms: *Central Exchange Ltd v Anaconda Nickel Ltd*' (2003) 31 UWAL Rev 293. However, these manifestations of good faith fall outside the scope of this article.
11. (1992) 26 NSWLR 234.
12. Above n 4.

The willingness of some courts to explicitly recognise an obligation of good faith has been lauded by some,[13] and condemned by others, who point to the considerable uncertainty that remains as to the content and scope of the obligation.[14] Nevertheless, it seems clear that good faith requires, at minimum, honesty, although it is also described in terms of an element of fidelity to the other party; an obligation to 'recognise and have due regard to the legitimate interests of both the parties'.[15] At its most general, good faith demands that people act honestly, and refrain from acting dishonestly, towards each other. Whether despite, or because of, the lack of a clear meaning, many courts have embraced the obligation. Finkelstein J recently conceded that the obligation may be incapable of precise definition, but suggested that good faith exists in the absence of bad faith.[16] His Honour and other judges have considered good faith to require parties not to act capriciously,[17] or unreasonably,[18] in exercising their contractual powers or discretions.

The High Court has yet to consider the existence and scope of the implied term of good faith in any detail, although the majority in *Royal Botanic Gardens and Domain Trust v South Sydney City Council*[19] recently acknowledged the importance of the issues raised by good faith.[20] More tellingly, in *Royal Botanic*, Kirby J observed that good faith appeared to conflict with the principle of caveat emptor, which lies at the heart of the common law conception of economic freedom.[21]

In Part I of this article it is noted that the traditional inclination of the courts to uphold economic freedom has long been subject to important qualifications upon the exercise of contractual powers, most notably in the form of the implied obligation of co-operation, and certain equitable controls over the exercise of contractual rights and powers.

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13. Eg, N Seddon & MP Ellinghaus (eds) *Cheshire & Fifoot's Law of Contract* 8th edn (Sydney: LexisNexis, 2002) para 10.43; Finn above n 6; A Mason 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 LQR 66.
14. Eg, A Baron 'Good Faith in Construction Contracts – From Small Acorns Large Oaks Grow' (2002) 22 ABR 54; Carter & Peden above n 5; J Carter & A Stewart 'The High Court and Contract Law in the New Millennium' (2003) 6 FLJR 185; J Carter & A Stewart 'Interpretation, Good Faith and the "True Meaning" of Contracts: The Royal Botanic Decision' (2002) 18 JCL 182; Carlin above n 6.
15. *Overlook v Foxtel* above n 4, Barrett J 91,970. See also *ACI Operations Pty Ltd v Berri Ltd* [2005] VSC 201, Dodds-Streeton J para 176; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, paras 27-28.
16. See *Pacific Brands Sport & Leisure v Underworks Pty Ltd* (2005) 12 Aust Contract Reports 90-213, para 65.
17. *Garry Rogers Motors v Subaru* above n 4, Finklestein J 43,104.
18. *Renard* above n 11, Priestley JA 257-263.
19. (2002) 186 ALR 289.
20. Ibid, 301. The parties in that case agreed that their lease contained an implied term of good faith. Only the content of the term was in dispute. However, the case was decided on other grounds relating to interpretation of the express terms.
21. Ibid, 312. See also Callinan J's description of the parties' submissions on the good faith issue as 'rather far reaching': ibid, 327. Callinan J found it unnecessary to consider good faith, deciding the appeal on other grounds.

Part II examines the role of good faith in foreign jurisdictions, particularly the United States. It is suggested that the US courts' use of good faith is substantially similar to the use by Australian courts of the obligation of co-operation.

In Part III it is argued that the results in *Renard* and *Burger King* do not differ from the results which could have been achieved by application of the more familiar principles discussed in Part I.

Part IV then examines some practical aspects of the implied obligation of good faith which may distinguish it from the obligation of co-operation, specifically, the source of the obligation, whether the obligation can be excluded and the extent to which the concept of 'reasonableness' (with which good faith is often coupled) has any independent content. It is suggested that, with the exception of the hitherto undefined notion of reasonableness, it may well be that the implied obligation of good faith is no more than old wine in new bottles.

I. TRADITIONAL METHODS OF CONTROLLING CONTRACTUAL PERFORMANCE

The contemporary debate over good faith in the performance of contracts can be situated within a much larger and enduring contest between two of contract law's fundamental objects: fairness and freedom of contract.[22] The classical position is that courts will enforce to the letter bargains freely entered into by competent parties.[23] As Jessel MR declared in *Printing and Numerical Registering Co v Sampson*:

> The one thing which, more than [any other], public policy requires is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely shall be held sacred and shall be enforced by the courts of justice.[24]

In more recent times, many scholars have sounded the retreat from the classical position,[25] citing the incursion of equitable principles,[26] statutory

22. Over the past several decades a large body of literature has developed on this topic: see generally G Gilmore *The Death of Contract* (Ohio: Ohio State UP, 1974); PS Atiyah *The Rise and Fall of Freedom of Contract* (Oxford: OUP, 1979); MJ Trebilcock *The Limits of Freedom of Contract* (Cambridge: Harvard UP, 1993); A Mason 'Contract: Death or Transfiguration?' (1989) 12 UNSWLJ 1; J Beatson & D Friedman 'Introduction: From "Classical" to Modern Contract Law' in J Beatson & D Friedman (eds) *Good Faith and Fault in Contract Law* (Melbourne: OUP, 1995).
23. For an explanation of the origins of freedom of contract in laissez-faire economics and political thought, see generally Atiyah ibid.
24. *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462, 465.
25. See the sources cited above n 22.
26. Such as estoppel (eg, *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387) and unconscionability (eg, *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447).

developments,[27] and the common law's reform of its own less forgiving doctrines.[28] It has also been recognised that many modern contractual relationships no longer conform to the classical model of one-off, arm's-length exchanges.[29] The open recognition by some courts of an implied obligation of good faith could, therefore, be seen as indicative of the pendulum of the common law swinging further away from the classical position toward a general notion of fairness.

Yet reports of the 'death of contract' may have been greatly exaggerated. In general, courts continue to respect party autonomy, displaying an evident preference for contractual certainty over more idiosyncratic forms of justice.[30] Moreover, the law has always imposed some restraints on the manner in which contracting parties perform their obligations and exercise their rights and powers. Accordingly, it may be questioned whether the enunciation of an obligation of good faith constitutes any real alteration of the existing balance which has been struck between fairness and certainty. Two of the existing methods by which contractual performance has been controlled are of particular relevance to the debate surrounding the obligation of good faith: the implied obligation of co-operation and equitable restraints on the exercise of a contractual right or power.

1. Implied term of co-operation

The implication of contractual terms has traditionally been at the frontline of the conflict between fairness and freedom of contract.[31] The reluctance of courts to imply terms, and thereby interfere with parties' bargains, was recently articulated by Kirby J in *Roxborough v Rothmans of Pall Mall Australia Ltd*,[32] where his Honour noted that:

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27. In *Renard* above n 11, 268, Priestley JA cited a number of examples from NSW, including: Money-lenders and Infant's Loans Act 1905 (NSW); Hire Purchase Agreements Act 1941 (NSW); Contracts Review Act 1980 (NSW); Credit Act 1984 (NSW); Trade Practices Act 1974 (Cth) s 51A (now ss 51AA, AC) .
28. Eg, the privity rule, in the context of insurance contracts: *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107.
29. Commentators focus increasingly on the particular circumstances of the case and the peculiar requirements of 'consumer' and 'relational' contracts: eg, Finn above n 6; cf M Gleeson 'Individualised Justice – The Holy Grail' (1995) 69 ALJ 421.
30. Eg, *Perre v Apand* (1999) 198 CLR 180, McHugh J 224: 'The common law has generally sought to interfere with the autonomy of individuals only to the extent necessary for the maintenance of society'; and generally, Gleeson ibid.
31. Another example is in the interpretation of restraint of trade clauses: eg, *Peters (WA) Ltd v Petersville Ltd* (2001) 205 CLR 126, Gleeson CJ, Gummow, Kirby & Hayne JJ 143, referring to *Peter's American Delicacy Co Ltd v Patricia's Chocolates and Candies Pty Ltd* (1947) 77 CLR 574, Dixon J 590, where his Honour described the problem 'of placing the public policy of securing an ample freedom of contract and enforcing obligations assumed in its exercise in opposition to the public policy of preserving freedom of trade from unreasonable contractual restriction'.
32. (2001) 208 CLR 516. Kirby J has elsewhere noted that courts should be wary of substituting lawyerly conscience for the hard-headed decisions of business people: *Austotel Pty Ltd v Franklins Self Serve Pty Ltd* (1989) 16 NSWLR 582, Kirby J 585.

> It would always be necessary for a court of our legal tradition to be very cautious about the imposition on the parties of a term that, for themselves, they had failed, omitted, or refused to agree upon. Such caution is inherent in the economic freedom to which our law of contract gives effect.[33]

Nevertheless, the High Court has recently reiterated that the law implies a positive obligation on contracting parties to do all such things that are necessary on their part to enable the other party to have the benefit of the contract, as well as a negative covenant not to hinder the fulfillment of the purpose of the express contractual promises.[34]

(i) Positive obligation to co-operate

In 1881, Lord Blackburn in *Mackay v Dick*[35] held that where contracting parties agree that something shall be done that requires co-operation, each party is taken to have impliedly agreed to do all that is necessary to ensure that it is done.[36] Shortly thereafter, a similar principle was recognised in Australia in *Butt v M'Donald*, where Griffith CJ 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 of the contract.[37]

This principle was subsequently endorsed by the High Court in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd*.[38] Mason J noted that both parties had accepted that the contract imposed an implied obligation on each party to do all that was reasonably necessary to secure performance of the contract.[39] His Honour also noted that:

> It is easy to imply a duty to co-operate in the doing of acts which are necessary to the performance by the parties or by one of the parties of fundamental obligations under the contract. It is not quite so easy to make the implication when the acts in question are necessary to entitle the other contracting party to a *benefit* under

33. *Roxborough v Rothmans* ibid, 575-576. See also *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337, Mason J 346.
34. *Peters v Petersville* above n 31, Gleeson CJ, Gummow, Kirby & Hayne JJ 142.
35. (1881) 6 App Cas 251.
36. Ibid, 263.
37. *Butt v M'Donald* (1896) 7 QLJ 68, Griffith CJ 71 (Power & Cooper JJ concurring). The obligation is sometimes expressed slightly differently, as being to take all reasonable steps to render the contract efficacious: *Butts v O'Dwyer* (1952) 87 CLR 267, Dixon CJ, Williams, Webb & Kitto JJ 279-280; *Pierce Bell Sales Ltd v Frazer* (1973) 130 CLR 575, 587; *Ginger Development Enterprises Pty Ltd v Crown Developments Australia Pty Ltd* (2003) 12 BPR 22, 607.
38. (1979) 144 CLR 596.
39. Ibid, Mason J 607 (with whom Barwick CJ, Gibbs, Stephen & Aickin JJ agreed).

> the contract but are not essential to the performance of that party's *obligations* and are not fundamental to the contract.[40]

His Honour opined that in the latter situation, the question whether the duty to co-operate is enlivened is to be resolved by reference to the intentions of the parties, as manifested by the contract.[41] Sir Anthony elaborated upon this distinction extra-curially:

> It may be going too far to say that the implied obligation results in a duty to co-operate to achieve the contractual objects. The implied obligation does no more than spell out what, on the true construction of the contract, is the effect of the promises and undertakings entered into by the party. In reaching that conclusion it will be relevant to take account of the legitimate, or reasonable expectations of the parties when they make the contract.[42]

This passage suggests quite a limited duty, which merely underscores the express obligations of the contract, and which seemingly does not give rise to any freestanding obligations or prescriptions as to quality of performance. However, Sir Anthony also acknowledged the relevance of the legitimate expectations of the parties, an evaluative consideration in conflict with the traditional preference for enforcing contracts in accordance with their express terms.

The apparent uncertainty in Sir Anthony's explanation reflects the tension between fairness and certainty that is inherent in the implication of terms. That same tension is evident in the varying degree of co-operation which the courts have required of parties in subsequent cases.

In *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd*,[43] the New South Wales Court of Appeal held the obligation of co-operation extended only to preventing interference with the parties' obligations under the contract. The court held that the obligation to co-operate did not extend to the 'bringing about [of] something which the contract does not *require* to happen'.[44] The basis for this conclusion was said to be that a term will only be implied in law where it is necessary, and, therefore, the extent of the co-operation required in each case 'must be limited by the extent of the need'.[45]

However, as Mason J made clear in *Secured Income*, the extent of the co-operation which is necessary must be determined, not only from the express promises of the

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40. Ibid (emphasis added).
41. Ibid, 607-608.
42. Mason, above n 13, 75.
43. (1998) 43 NSWLR 104.
44. Ibid, 124.
45. Ibid, quoting *Board of Fire Commissioners (NSW) v Ardouin* (1961) 109 CLR 105, Kitto J 118. The test for implication of a term by law is set out below pp 100-101.

contract, but also from the intentions of the parties, and the circumstances of the particular case.[46]

As a result, the degree of co-operation required may vary from case to case. For example, in *Forklift Engineering Australia Pty Ltd v Powerlift*,[47] Warren J, as she then was, described a more expansive obligation, requiring contracting parties to –

> act in accordance with the objective of the contract, that is, each party must comply not merely with the strict terms of the contract but act with due regard to the objective to which the contract is directed.[48]

Such a focus on achieving the 'objective' of the contract, as distinct from the express promises contained with in it, imports a potentially broader obligation than the New South Wales Court of Appeal's austere formulation of the obligation in *Australis*.[49]

(ii) Negative covenant not to hinder fulfilment of express contractual promises

The positive aspect of the implied obligation of co-operation is complemented by a negative covenant not to hinder or prevent the fulfilment of the purpose of the express promises made in the contract.[50] The authority invariably cited for this proposition in Australia is *Shepherd v Felt and Textiles of Australia Ltd*, where Dixon J held the contract in issue –

> inevitably imported a tacit condition that the appellant should perform the services faithfully which he contracted to give the respondent, and should not endeavour to impede or defeat the respondent in the sale of its manufactures.[51]

In *Peters v Petersville*, the High Court expressed this obligation as ensuring 'fulfilment of the purpose of the express promises of the contract',[52] and therefore this aspect of the obligation may be subject to the same limitations identified in *Australis*.

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46. *Secured Income* above n 38, 607-608.
47. [2000] VSC 443.
48. Ibid, Warren J para 90.
49. Warren J's focus on the 'objective' of the contract in *Forklift,* ibid, is suggestive of the concept of loyalty to the contract, or loyalty to the promise itself, which some commentators have suggested is the core meaning of good faith: HK Lucke 'Good Faith and Contractual Performance' in PD Finn (ed) *Essays on Contract* (Sydney: Law Book Co, 1987) 161-164; Mason above n 13, 74.
50. *Peters v Petersville* above n 31, 142.
51. *Shepherd v Felt and Textiles of Australia Ltd* (1931) 45 CLR 359, Dixon J 378. The contract in issue was an agency agreement, which the agent alleged the principal wrongly terminated. The principal successfully argued the agent had breached its express promise to use his best endeavours on behalf of the principal, as well as the negative covenant not to hinder or prevent the fulfilment of the purpose of the agreement.
52. *Peters v Petersville* above n 31, 142.

A similar obligation has also been acknowledged in England, where the courts recognise an implied condition that parties to a contract shall not do anything to prevent the other party from performing the contract.[53]

(iii) The source of the obligation of co-operation

A significant feature of the debate over the obligation of good faith in Australian law concerns whether the obligation is properly a term to be implied (whether in fact or in law), or a canon of construction or rule of general application.[54]

The source of the obligation of co-operation has attracted less consideration. The orthodox approach, drawn from *Butt v M'Donald*, is that the obligation of co-operation is a term to be implied in all contracts.[55] Nevertheless, it has occasionally been suggested that co-operation is, in fact, a principle of construction.[56] In the recent New South Wales Court of Appeal case, *Vodafone Pacific Ltd v Mobile Innovations Ltd*,[57] Giles JA reviewed the relevant authorities, some of which referred to construction, and some to implication, concluding:

> If there is a process of construction, it accommodates the notion of implication, that is, the imposition of a legal obligation not based on actual intention of the parties.[58]

This somewhat sanguine approach is also evident in *Australis*, where the court accepted that the contract in question gave rise to an obligation of co-operation, 'whether as a matter of construction, a rule of law, an implied term, or as part of the proper understanding of the doctrine of breach'.[59] Indeed, Professor Carter believes that it does not matter which method is used.[60]

The imprecision with which the courts have incorporated obligations of co-operation into contracts may be attributable to the obligation being recognised prior to the

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53. *Barque Quilpue Ltd v Brown* [1904] 2 KB 264, Williams VC 271, cited in JF Burrows 'Contractual Co-operation and The Implied Term' (1968) 31 MLR 390, 401; *William Cory & Son Ltd v London Corporation* [1951] 2 KB 476, Lord Asquith 484.
54. The source of the obligation of good faith is discussed below pp 97-102.
55. *Butt v M'Donald* above n 37, 71. Griffith CJ stated that the principle was 'applicable to all contracts' and arose by implication.
56. Eg, Peden above n 5, 66; E Peden *Good Faith in the Performance of Contracts* (Sydney: LexisNexis, 2003) 113; Burrows above n 53, 401.
57. Above n 4.
58. Ibid, para 203.
59. *Australis* above n 43, 125.
60. J Carter *Breach of Contract* 2nd edn (Sydney: Law Book Co, 1991) 37. In a practical sense, Carter may be right, as a construction or 'rule of law' approach is unlikely to affect whether the obligation may be excluded, or the remedies available: see E Peden 'Incorporating Terms of Good Faith in Contract Law in Australia' (2001) 23 SLR 222, 231.

modern tests for implication of terms becoming settled.[61] Perhaps more practically significant is the question whether contractual parties can exclude the obligation of co-operation.

(iv) Exclusion of the obligation of co-operation

Whether contractual parties may disclaim the implied obligation of co-operation has not been squarely dealt with by the courts. As a general rule, an implied term may be excluded either expressly or by inconsistency with the express terms of the contract.[62] It has been suggested that the exclusion of an obligation of co-operation might render the contract illusory.[63] However, that proposition is doubtful, as the parties would still be required to perform according to the express terms of the contract.[64] Moreover, it seems implicit in Mason J's discussion in *Secured Income* of the limits of the obligation of co-operation that the obligation will not be implied where it is inconsistent with the intentions of the parties.[65]

Like many aspects of the obligation of co-operation, the issue of whether the obligation can be excluded has been overshadowed by discussion of the obligation of good faith,[66] and the issue awaits conclusive consideration by the courts.

(v) Overlap between co-operation and good faith

In a 1968 survey of the use of 'co-operation' in English law, Burrows concluded that in all its guises, co-operation fell short of the concept of good faith.[67] However, this

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61. See the discussion in *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, Hope JA 492; *Codelfa Construction* above n 33, Mason J 345-346, referring to Simonds VC's recognition in *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555, 576, that implication by law was based on more general considerations.
62. *Castlemaine v Carlton* ibid, Hope JA 490-493.
63. P Heffey, J Patterson & A Robertson *Principles of Contract Law* (Sydney: Law Book Co, 2002) 271. The issue of illusory consideration typically arises when one party has a discretion whether to perform the contract at all: see eg *Placer Development Ltd v Commonwealth* (1969) 121 CLR 353.
64. It is established that parties must perform their contractual obligations, and do not have the right to elect simply to pay damages in lieu of performance: see eg *Ahmed Angullia v Estage & Trust Agencies (1927) Ltd* [1938] AC 624, 634; *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460, Windeyer J 500.
65. *Secured Income* above n 38, 607-608; also *Nullagine Investments Pty Ltd v Western Australian Club Inc* (1993) 177 CLR 635, Deane, Dawson & Gaudron JJ 659-660, holding that there was 'no room to imply' an obligation to co-operate that extended beyond the 10 year term of the contract in question.
66. Whether contracting parties can exclude the obligation of good faith is discussed below: pp 97-102.
67. Burrows above n 53, 405. However, Burrows was referring to the Roman use of good faith, which permitted the court to order parties to a commercial contract to do such things, or pay such sums, as it found to be due ex bona fides (in accordance with the requirements of good faith). See R Powell 'Good Faith in Contracts' (1956) 9 CLP 16, 20-21; JF O'Connor

conclusion may not now hold true, if it ever did.[68]

Similarities between the two concepts are apparent in a number of Australian decisions. For example, in *Gregory & Bradshaw v MAB Pty Ltd*,[69] Malcolm CJ professed 'no difficulty' in implying an obligation on the part of the respondents to formulate a development proposal in good faith, honestly, and using their best endeavors,[70] concluding that there was an implied obligation to do everything reasonably necessary to secure performance of the contract.[71] That his Honour used good faith and co-operation interchangeably suggests a significant overlap of the two concepts.

More explicitly, in *Service Station v Berg Bennett,* Gummow J considered the United States implied covenant of good faith had similar origins and content to the Anglo-Australian implied obligation of co operation,[72] a view that was apparently endorsed by Steytler J in *Central Exchange Ltd v Anaconda Nickel Ltd*.[73] Steytler J noted that, although the precise content of the implied term of good faith awaited refinement, it was 'questionable just how much an implied term of that kind would add'[74] to the implied term of co-operation in combination with existing equitable principles controlling the exercise of contractual power.

2. Equitable controls over the exercise of contractual power

Equity has also traditionally intervened to control the exercise of contractual rights or powers. In *Aleyn v Belchier*, for example, Lord Northington declared that:

> No point is better established than that, a person having a power must execute it bone fide for the end designed, otherwise it is corrupt and void.[75]

Good Faith in English Law (Dartmouth: Gower, 1990) 2. As such, the Roman concept of good faith was significantly broader than the concept as it is employed by Australian and even US courts. See below pp 79-80.

68. Eg, C Rickett 'Some Reflections on Open-Textured Contracting' [2001] AMPLA Yearbook 374, 385-391; LJ Priestley 'A Guide to a Comparison of Australian and United States Contract Law' (1989) 12 UNSWLJ 4, 23; R Ladbury 'Implied Duty of Good Faith: A Comment' [2002] AMPLA Yearbook 22, 25.
69. (1989) 1 WAR 1.
70. As to the relationship between good faith and express or implied best, or reasonable, endeavours clauses, see Rickett above n 68, 385-391.
71. *Gregory & Bradshaw v MAB* above n 69, Malcolm CJ 15 (Brinsden J concurring). Malcolm CJ made a similar comment in *Central Exchange v Anaconda Nickel* above n 4, 38: 'The obligation by each party to do all that is necessary on his part to enable the other party to have the benefit of the project carries with it the suggestion of an implication that the parties to a contract are obliged to deal with one another in good faith to ensure that each will have the benefit of performance of the contract by the other'.
72. *Service Station v Berg Bennett* above n 1, 405.
73. Above n 4.
74. Ibid, 52.
75. *Aleyn v Belchier* (1758) 28 ER 634, 637, cited in *Mills v Mills* (1937) 60 CLR 150, Dixon J 185.

This venerable principle has found expression in various contexts, such as the rule that the power of company directors to issue shares in a company must not be exercised for an improper[76] or irrelevant purpose.[77] Similarly, a vendor must not rescind a contract for the sale of land for an improper or extraneous purpose.[78] In *Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd*,[79] Stephen J noted that the courts had traditionally restrained a vendor's right of rescission either by:

(i) finding that, as a matter of construction, the circumstances of the particular case do not fall squarely within the terms of the clause; or

(ii) acknowledging the clause applied, but holding that having attempted to use the rights conferred upon him for an improper purpose, the vendor could not be permitted to rely on the contractual right.[80]

In *Pierce Bell Sales Ltd v Frazer*,[81] Barwick CJ, after citing *Godfrey Constructions*, explained that a vendor would not be permitted to rely on a right to rescind where to do so would be unconscionable.[82] However, his Honour's reference to unconscionability in this context must be understood as referring to equity's general concern to prevent that which 'ought not, in conscience'[83] to be allowed, rather than any explicit connection between this principle and the doctrine of unconscionable conduct or equitable relief against forfeiture.[84]

The courts, in explicating the role of good faith in the performance of contracts, have done so by analogy with these equitable principles.

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76. *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, Lord Wilberforce 835; *Mills v Mills* ibid, Dixon J 185.
77. *Harlowe's Nominees Pty Ltd v Woodside (Lake's Entrance) Oil Co NL* (1968) 121 CLR 483, Barwick CJ, McTiernan & Kitto JJ 493.
78. In *Gardiner v Orchard* (1910) 10 CLR 722, 739-740, Isaacs J observed that in deciding whether a vendor is entitled to exercise its right of rescission, the court must bear in mind: the purpose of the condition (which is a matter of law); the necessity for bona fides on the part of the vendor in using his power for that purpose; and that the cancellation must be reasonable, by reference all the circumstances, and particularly to the wording of the contract.
79. (1972) 128 CLR 529.
80. Ibid, 549. Stephen J referred to the observation in *Webster's Conditions of Sale* that this was not properly a matter of construction, as the court is really interfering in the contract to prevent a fraud being committed. His Honour noted that '[i]t perhaps matters little which of these two approaches be preferred; there may, on analysis, be no very clear distinction between them'.
81. Above n 37.
82. Ibid, 587.
83. *Commonwealth v Verwayen* (1990) 170 CLR 394, Deane J 440; *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, 72-74.
84. For which proof of 'unconscientious conduct' is a necessary, but not sufficient, condition: *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, 325.

(i) Relationship of equitable controls over contractual power and good faith

In reviewing the development of the implied term of good faith, Sheller JA in *Alcatel* explained:

> If a contract confers power on a contracting party in terms wider than necessary for the protection of the legitimate interests of that party, the courts may interpret the power as not extending to the action proposed by the party in whom the power is vested or, alternatively, conclude that the powers are being exercised in a capricious or arbitrary manner or for an extraneous purpose, which is another way of saying the same thing.[85]

Sheller JA seemingly envisaged that the implied term of good faith might perform a similar role to the equitable principles referred to in *Godfrey Constructions*.[86] Indeed, in *Alcatel*, the court dismissed an allegation that the obligation of good faith had been breached on the basis there was nothing to suggest the respondent had acted for an improper purpose.[87]

A similarly composed court[88] also referred to these equitable principles in the *Burger King* decision. The court, in explaining the developing content of good faith, quoted the above passage from *Alcatel*,[89] as well as similar comments in *Renard*[90] by Priestley JA, who described the equitable principles and good faith as 'related topics', despite their usually being dealt with separately.[91]

The similarity between the circumstances in which equity will intervene and those in which good faith operates was most recently noted by Giles JA in *Vodafone*,[92]

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85. *Alcatel* above n 4, 368. His Honour then referred to the conclusion of Barwick CJ in *Pierce Bell Sales v Frazer* above n 37, 587, that a vendor may not be able to exercise a contractual power of rescission where to do so would be unconscionable.
86. Above n 79. See also *Mitchell v Pattern Holdings Pty Ltd* (2002) 11 BPR 20, 241; *Hilton Hotels (Australia) Pty Ltd v Sunrise Resources (Australia) Pty Ltd* (2000) 9 BPR 17, 495, para 27.
87. *Alcatel* above n 4, 370. See also *Far Horizons v McDonald's* above n 4, paras 119-141, where Byrne J focused on the purpose for which the impugned conduct was engaged, and whether that was proper, having regard to the contract: *Varangian Pty Ltd v OFM Capital Ltd* [2003] VSC 444, Dodds-Streeton J paras 177-178.
88. Sheller and Beasley JJA were members of the court in both *Alcatel* above n 4 and *Burger King* above n 4.
89. *Burger King* ibid, para 155.
90. Above n 11, para 151.
91. *Renard* ibid, 263. See also *Garry Rogers Motors v Subaru* above n 4, 43,014, where Finkelstein J thought that an implied term requiring good faith imposed an obligation on the parties not to act capriciously, but emphasised that such a term would not prevent 'actions designed to promote the legitimate interests of that party'. His Honour's understanding of good faith arguably incorporates the concerns which have traditionally informed the courts' constraint of the manner in which contractual powers are exercised.
92. Above n 4.

who detected a 'developing relationship' between implied terms of co-operation, good faith or reasonableness, and equitable controls over the exercise of contractual power.[93] His Honour speculated that, in this respect, 'contract may take over from equitable principle'.[94] The 'relationship' to which Giles JA adverted has clearly been nurtured by the judicial use of equitable principle as an analogy by which to explain the content of the implied term of good faith.[95]

The relationship between these equitable principles and good faith has recently been noted in England. In *O'Neil v Phillips*,[96] Lord Hoffmann, speaking on behalf of the House of Lords, noted similarities between traditional equitable principles and the continental approach of requiring parties to act in good faith.[97] Similarly, in *Equitable Life Assurance Society v Hyman*,[98] Lord Cooke observed that 'no legal discretion, however widely worded … can be exercised for purposes contrary to those of the instrument by which it is conferred'.[99] His Lordship concluded that the power of directors of a pension society to issue bonuses could not be exercised for the purpose of reducing the total benefits payable to particular members of the society.[100] Lord Cooke thought that this was an alternative method of arriving at the same result as that reached by Lord Steyn, who recognised an implied term fettering the exercise of the directors' power,[101] an approach that comports with the way Australian courts have thus far approached good faith in contractual performance.[102]

Despite Anglo-Australian law's preference for freedom of contract, it has long tolerated some interference with contractual certainty by implying restrictions on the exercise of contractual powers. Against that background, the next Parts of this

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93. Ibid, para 217.
94. Ibid.
95. Barrett J in *Overlook v Foxtel* above n 4, 91,970, was somewhat more circumspect, noting that there was 'some overlap' between the implied terms of co-operation and the implied term of good faith. However, his Honour did not seem to think that co-operation was subsumed in good faith, describing the good faith as 'taking its place beside' the term of co-operation.
96. [1999] 1 WLR 1092.
97. Ibid, 1101. Those comments were made in the context of an action under the Companies Act 1989 (UK) challenging a majority shareholder's reliance on his strict rights. His Lordship thought that it would be useful in this context to 'ask whether the exercise of the power in question would be contrary to what the parties, by words or conduct, have actually agreed'.
98. [2002] 1 AC 408.
99. Ibid, 460, citing *Howard Smith v Ampol Petroleum* above n 76.
100. *Equitable Life Assurance Society v Hyman* ibid. Peden above n 56, 166, described Lord Cooke's approach as an example of the implementation of good faith through a process of construction; however, it may also be seen as an expression of the venerable equitable principles under discussion.
101. Ibid, Steyn LJ 459.
102. *Overlook v Foxtel* above n 4, 91,971. Barrett J observed that most of the Australian decisions dealing with the implied term of good faith have been concerned with the exercise of a right or power granted expressly by the contract in issue.

article consider how the concept of good faith has been used in Australia and in other jurisdictions, in order to ascertain the extent to which, if any, implied terms of good faith have altered the uneasy balance between certainty and fairness in Australian contract law.

II. GOOD FAITH IN FOREIGN JURISDICTIONS

Recognition of a contractual obligation of good faith is anything but novel. Good faith was a central tenet of Roman commercial law,[103] and remains a fundamental principle in many jurisdictions.[104] This Part briefly explores the use of good faith in common law jurisdictions other than Australia, focusing on the United States, where good faith has become a central pillar of contract law.[105] It is suggested the role of good faith, as expounded by the US courts, is substantially the same as the role of the implied obligation of co-operation in Australian law. Significantly, both Priestley JA in *Renard*, and the court in *Burger King* have referred to US case law in explicating the role of good faith in Australian law.[106]

1. English approach to good faith

In 1766, Lord Mansfield declared good faith to be a governing principle applicable to all contracts,[107] a view subsequently echoed by Lord Kenyon, who urged:

> In contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith.[108]

However, Lord Mansfield's dictum has now been confined to insurance contracts,[109] and English contract law has, in recent times, appeared hostile towards suggestions

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103. Powell above n 67, 20-21; FH Lawson *A Common Lawyer Looks at the Civil Law* (Michigan: University of Michigan Law School, 1953) 124-125, cited in Farnsworth above n 8, 669; RH Jerry 'The Wrong Side of the Mountain: A Comment on Bad Faith's Unnatural History' (1994) 72 Tex L Rev 1317, 1321.
104. Good faith figures prominently in the commercial law of many civil jurisdictions. For example, in France, Article 1134 of the Code Civile provides that all contracts are to be performed in good faith, while in Germany, s 157 of the Burgerliches Gesetzbuch provides that contracts must be interpreted in accordance with good faith, having regard to common usage, while s 242 provides that a debtor is bound to perform a contract in accordance with good faith, having regard to common usage. However, given the differences between civil and common law jurisdictions, this article will be confined to a discussion of common law jurisdictions more readily comparable with our own.
105. EA Farnsworth 'Ten Questions About Good Faith and Fair Dealing in United States Contract Law' [2002] AMPLA Yearbook 1, 1-2.
106. *Renard* above n 11, 265; *Burger King* above n 4, paras 173-174.
107. *Carter v Boehm* (1766) 97 ER 1162, 1164.
108. *Mellish v Motteux* (1792) 170 ER 113, 113-114. See also *Lumley v Wagner* (1852) 42 ER 687; R Brownsword 'Positive, Negative, Neutral: The Reception of Good Faith in English Contract Law' in R Brownsword, NJ Hird & G Howells (eds) *Good Faith in Contract: Concept and Context* (Hampshire: Ashgate, 1999) 13.
109. *Carter v Boehm* above n 107 remains authority for the common law duty of utmost good

of an explicit obligation of good faith. In *Walford v Miles*, for instance, Lord Ackner stated:

> 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.… A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent.[110]

One explanation for this hostility is that English courts, rather than adopting an overarching principle of good faith, have preferred to deal with issues of unfairness through the development of specific doctrines,[111] and the mollifying influence of equity.[112]

Good faith has received more positive treatment in the United Kingdom's former dominions. An obligation of good faith in the performance of contracts has been considered in South Africa,[113] and, to a lesser extent, in New Zealand.[114] However, it is in Canada and the United States that good faith has received the greatest judicial attention.

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faith in insurance law, which in Australia has been augmented by ss 12, 13 and 14 of the Insurance Contracts Act 1984 (Cth), which impose a duty of utmost good faith upon both insurer and insured.

110. *Walford v Miles* [1992] 2 AC 128, Lord Ackner 138. The case considered whether negotiating parties were bound by an agreement to negotiate in good faith. As it concerned a pre-contractual duty, *Walford v Miles* falls outside the scope of this article. Nonetheless, Lord Ackner's statement is indicative of the English courts' approach to good faith generally. Cf *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] 1 NZLR 289, Lord Browne Wilkinson 310.

111. Eg, *Interfoto Library Ltd v Stilleto Ltd* [1989] QB 433, Bingham LJ 439; J Steyn 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?' (1991) 1 DLJ 131.

112. As to the historical role of concepts such as good faith and 'conscience' in moulding equitable doctrines, see Powell, above n 67; and generally Atiyah above n 22; Finn above n 49, arguing that a number of the 'contract related doctrines' of equity, such as misrepresentation, mistake, and equitable estoppel, can be unified under the rubric of good faith.

113. *NBS Boland Bank v One Berg River Drive* (Unreported, Supreme Court of Appeal, No 291, 10 Sep 1999) paras 24 ff. The court considered that unless otherwise expressed, a contractual power or discretion is to be exercised in good faith. Being a mixed jurisdiction of common and civil law, the South African Supreme Court of Appeal cited the Roman Digests as authority. See also P Osode 'Farewell to the Contractual Discretionary Powers Concerns' (2000) 12 AJICL 170.

114. *Livingstone v Roskilly* [1992] 3 NZLR 230, 237, where Thomas J, in obiter dicta, described good faith as a 'latent premise' of New Zealand contract law. Cf *Bilgola Enterprises Ltd v Dymocks Franchise Systems (NSW) Pty Ltd* [2000] 3 NZLR 169, where the Court of Appeal, in a case governed by NSW law, suggested that there was no room to superimpose an obligation of good faith in commercial contracts. That case was appealed to the Privy Council, where Lord Browne-Wilkinson agreed with the Court of Appeal that the trial judge had insufficient expert evidence before him to justify the implication of a term of good faith: *Dymocks Franchise v Todd* above n 110, 307.

2. Canadian approach to good faith

In Canada, as in Australia, the precise role and scope of good faith is not yet settled. However, it is clear that an obligation of good faith will arise as an incident of all employment contracts,[115] and there is strong authority for the extension of the obligation to franchise agreements[116] and other long-term collaborative contracts.[117]

In *Transamerica Life Canada Inc v ING Canada Inc*,[118] the Ontario Court of Appeal observed that Canadian courts have not yet recognised a general, 'stand-alone,' duty of good faith independent from the terms of the contract. O'Connor ACJ noted that where the courts had implied a duty of good faith, they had done so 'with a view to securing the performance and enforcement of the contract', or to ensure that the parties do not act to defeat the objectives of their contract.[119] His Honour observed: 'it remains an open question whether implied duties of good faith add anything to the other available common law doctrines that apply to contracts'.[120]

O'Connor ACJ noted that the cautious approach of Canadian courts to recognising an obligation of good faith performance was to be contrasted with the broad recognition of that obligation in the US.[121]

3. United States approach to good faith

For over a century, courts in New York[122] and elsewhere have recognised a common law duty of good faith in the performance of contracts.[123] In 1933, in *Kirke La Shelle Co v Paul Armstrong Co*, Hubbs J held that:

115. *Wallace v United Grain Growers Ltd* [1997] 3 SCR 701, in which the Supreme Court considered the unique features of employment relationships warranted the imposition of an obligation of good faith.
116. *Shelanu Inc v Print Three Franchising Corp* (2003) 226 DLR (4th) 577 (a decision of the Ontario Court of Appeal); *Imasco Retail Inc v Blanaru* [1997] 2 WWR 295 (a decision of the Manitoba Court of Appeal).
117. See *Gateway Realty Ltd v Arton Holdings Ltd (No 3)* (1991) 106 NSR (2d) 180, 197. That case was cited in *Service Station v Berg Bennett* above n 1, Gummow J 402.
118. (2004) 234 DLR (4th) 367.
119. Ibid, 378. Cf *Peel Condominium Corp No 505 v Cam-Valley Homes Ltd* (2001) 196 DLR (4th) 621, in which the Ontario Court of Appeal apparently approved of the implication of good faith in commercial contracts generally, albeit by way of obiter dicta.
120. *Transamerica Life v ING* ibid. However, the court upheld an appeal from a decision striking out a claim the appellant had breached a duty of good faith during negotiations towards the sale of an insurance business, holding that the issue should be determined at trial: ibid, 379. See also *Haggart Construction Ltd v Canadian Imperial Bank of Commerce* [1998] Lloyd's Rep Bank 297.
121. *Transamerica Life v ING* ibid, 378.
122. Eg *Doll v Noble* 22 NE 406 (NY 1889); *Genet v President of Delaware & Hudson Canal Co* 32 NE 1078, 1082 (NY 1893); *New York Central Ironworks Co v US Radiator Co* 66 NE 967, 968 (NY 1903); *Wood v Lucy, Lady Duff-Gordon* 118 NE 214 (NY 1917); *Wigand v Bauchmann-Bechtel Brewing Co* 118 NE 618, 619 (NY 1918).
123. Farnsworth above n 8, 669, noting that the obligation was not widely recognised outside of New York and California before the promulgation of the first Official Text of the UCC in 1962.

> In every contract 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*.[124]

The implied covenant of good faith is now a part of the common law of most US states.[125] However, in the United States, unlike in Australia, good faith also has a statutory basis.[126]

(i) Uniform Commercial Code

Perhaps the most significant recognition of good faith in United States contract law is clause 1-203 of the Uniform Commercial Code,[127] which imposes a general obligation of good faith in the performance and enforcement of every contract within its purview.[128] Good faith is perfunctorily defined in clause 1-201(19) to mean 'honesty in fact in the conduct of the transaction concerned'.[129]

This statutory duty is echoed in clause 205 *Restatement of Contracts (2nd)*, which differs from UCC clause 1-203 only in the addition of the phrase 'fair dealing' to the duty of good faith. The 'Comment' to clause 205 describes good faith, rather than defining it:

> Good faith performance or enforcement of a contract emphasises faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterised as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness.[130]

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124. *Kirke La Shelle Co v Paul Armstrong Co* 188 NE 163 (1933), 167 (emphasis added). Cf Gummow J in *Service Station v Berg Bennett* above n 1, 405, where his Honour expressed the opinion that the italicised passage ought to be read either as a summary of the preceding obligation, or as a non sequitur.
125. SJ Burton 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1980) 94 HLR 369, 369.
126. However, see TPA s 51AC(3), which provides that in determining whether conduct is unconscionable in contravention of s 51AC(1) or (2), the court may have regard to a range of factors, including good faith.
127. The Uniform Commercial Code (UCC) has been enacted in the local law of each state (other than Louisiana, where the majority of the UCC's provisions have nonetheless been adopted in a variant of the Napoleonic Code) in various versions, depending on the date of enactment: J White & R Summers (eds) *Uniform Commercial Code* 3rd edn (Minnesota: West Pub Co, 1988) 1.
128. Burton 'above n 125, 369; HO Hunter 'The Growing Uncertainty About Good Faith in American Contract Law' (2004) 20 JCL 50, 50.
129. More specific (though no less economical) definitions are given in relation to particular situations, eg cl 2-103(1)(b) (sale of goods) and cl 3-103(a)(4) (negotiable instruments).
130. This description incorporates Summers' influential description of good faith as an 'excluder', positing that good faith, having no positive meaning of its own, serves to exclude a variety of heterogenous forms of bad faith: RS Summers 'Good Faith in General Contract Law and

While the *Restatement* is not binding, it is regarded as a highly persuasive distillation of the common law.[131] Moreover, the *Restatement* applies generally, unlike the UCC, which applies only to sales contracts.[132]

In a seminal article published shortly after the promulgation of the UCC, Professor Farnsworth expressed the opinion that the UCC provisions required 'co-operation on the part of one party to the contract so that another party will not be deprived of his reasonable expectations'.[133] Accordingly, Farnsworth opined that the roles afforded to good faith by the UCC do 'not go beyond those to which the traditional techniques of interpretation and gap filling were put in yesteryear'.[134]

(ii) United States case law on good faith

The implied covenant of good faith has since been considered in hundreds of decisions,[135] meaning that, even by United States standards,[136] it is difficult to speak authoritatively of a uniform judicial approach to good faith.[137] There is, however, a strong line of authority constraining good faith within quite narrow parameters.

In *Kham & Nate's Shoes (No 2) Inc v First Bank of Whiting*,[138] Easterbrook J observed that contractual parties are entitled to literal enforcement of the contract 'even to the great discomfort of their trading partners, without being mulcted for lack of "good faith"'.[139] Similarly, in *Metropolitan Life Insurance Co v RJR Nabisco Inc*, Walker J explained that:

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the Sales Provisions of the Uniform Commercial Code' (1968) 54 VLR 195, 196, 201. The other significant academic definition of good faith in the US is Burton's 'forgone opportunity' approach, which urges proscription of the exercise of a contractual discretion to recapture economic or commercial opportunities forgone upon contracting: see eg Burton above n 125.

131. Drafted by the American Law Institute, the *Restatement* is regularly referred to by US courts: eg *United States v Basin Electric Power Co-Op* 248 F 3d 781, 796 (2001); and Australian courts: eg *Renard* above n 11, 267; *Service Station v Berg Bennett* above n 1, 401; *Alcatel* above n 4, 364; *Central Exchange v Anaconda Nickel* above n 4, 51.
132. For an overview of the evolution of the *Restatement (Second) of Contracts*, see R Summers 'General Duty of Good Faith – Its Recognition and Conceptualisation' (1982) 67 Cornell LR 810, 812.
133. Farnsworth above n 8, 669.
134. EA Farnsworth *Contracts* 2nd edn (Boston: Little Brown, 1990) 17.17a, cited in *Service Station v Berg Bennett* above n 1, Gummow J 402. For Farnsworth, the significance of the UCC provisions is in their implication of terms into all sales contracts: Farnsworth ibid.
135. Hunter above n 128, 50.
136. See A Mason 'The Use and Abuse of Precedent' (1988) 4 ABR 93, 108, warning that the 'trackless jungle' of US case-law seems able to provide authority for any conceivable proposition of law.
137. Hunter above n 128, 51, who warns that US law remains unsettled. See also SW Goren 'Looking For Law in All the Wrong Places: Problems in Applying the Implied Covenant of Good Faith Performance' (2003) 37 USFLR 257; cf Farnsworth above n 105, 20-21.
138. 908 F 2d 1351 (1990).
139. Ibid, 1357.

> [The] implied covenant of good faith is breached only when one party seeks to prevent the contract's performance or to withhold its benefits. As a result, it thus ensures that parties to a contract perform the substantive, bargained for terms of their agreement.[140]

Although the restrictive approach evident in such cases has been the subject of some criticism,[141] it has received wide judicial endorsement in the United States. Importantly, it is by reference to such cases that the Australian courts have developed the concept of good faith in contractual performance. This is not surprising, as, under the restrictive approach, good faith is analogous to the implied obligation of co-operation. Indeed, Griffith CJ's description of the obligation of co-operation in *Butt v M'Donald*[142] is scarcely distinguishable from the Eighth Circuit Court of Appeals' explanation in *Conoco Inc v Inman Oil Co Inc*[143] that the obligation of good faith imposes –

> upon each party the duty to do nothing destructive of the other party's right to enjoy the fruits of the contract and to do everything that the contract presupposes they will do to accomplish its purpose.[144]

The United States courts also appear to have encountered the difficulty identified by Mason J in *Secured Income*,[145] of deciding whether to require the doing of something that, although not expressly required by the contract, is necessary to allow the other party their anticipated benefits.[146] For example, in *Carma Developers (California) Inc v Marathon Development California Inc*,[147] Puglia ACJ noted that while it may be simple to determine whether given conduct falls within the express promises of the contract, 'difficulty arises in deciding whether such conduct, though not prohibited, is nevertheless contrary to the contract's purposes and the parties' legitimate expectations'.[148]

Similarly, the concern of the courts that contracts should be performed, encapsulated in Australia in the negative covenant not to hinder the fulfilment of the express

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140. *Metropolitan Life Insurance Co v RJR Nabisco Inc* 716 F Supp 1504, 1517 (SDNY 1989); *Rio Algom Corp v Jimco Ltd* 618 P2d 497, 505 (1980), where the court held that: '[a] duty of good faith does not mean that a party vested with a clear right is obligated to exercise that right to its own detriment for the purpose of benefiting another party to the contract. A court will not enforce asserted rights that are not supported by the contract itself.'
141. Eg MP Van Altsine 'Of Textualism, Party Autonomy, and Good Faith' (1999) 40 WMLR 1223, 1227-1228; DM Patterson 'A Fable From the Seventh Circuit: Frank Easterbrook on Good Faith' (1991) 76 Iowa L Rev 503.
142. *Butt v M'Donald* above n 37, 70-71. Griffith CJ's statement is set out above p 68.
143. 774 F 2d. 895 (1985).
144. Ibid, 908, referred to by Finn J in *Hughes Aircraft v Airservices Australia* above n 4, 36.
145. See the passages extracted above pp 68-70.
146. *Secured Income* above n 38, 607.
147. 826 P 2d 710 (Cal 1992).
148. Ibid, Puglia ACJ 727.

promises,[149] is equally apparent in this passage from the New York case, *Weider v Scala*:

> In every contract there is an implied undertaking on the part of each party that he will not intentionally and purposely do anything to prevent the other party from carrying out the agreement on his part.[150]

This necessarily brief survey of the US approach to the implied covenant of good faith suggests that is not a sui generis concept, but rather 'a re-christening of fundamental principles of contract law well established' in the general law.[151]

A similar conclusion was reached two decades ago by McLelland J, who considered a dispute governed by New York law in *US Surgical Corp v Hospital Products International*.[152] His Honour observed that the use of the implied covenant of good faith in US law did not appear at odds with the law of New South Wales at the time, and, indeed, was not materially different from the principle expressed in *Secured Income* and *Butt v M'Donald*.[153] The discussion in the following Part of the leading Australian cases on good faith suggests that, in this country too, the implied obligation of good faith does not materially depart from the familiar principles by which contractual performance has hitherto been regulated.

III. THE DECISIONS OF THE NEW SOUTH WALES COURT OF APPEAL

The preceding Parts of this article have noted similarities between the ways in which Anglo-Australian courts have traditionally supervised contractual performance and the use to which the implied term of good faith has been put in the United States. This Part explores two recent cases in which the New South Wales Court of Appeal identified breaches of the implied terms of good faith or reasonableness. It will be argued that the results in these cases could have been reached by using the more familiar principles discussed in Part I.

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149. Discussed above pp 70-71.
150. *Weider v Scala* 609 NE 2d 105 (1992), 109. See also *Comprehensive Care Corporation v Rehabcare Corporation* 98 F 3d 1063, 1066 (1996), where Rosenbaum J made the point that: '[t]he law does not allow the implied covenant of good faith and fair dealing to be an everflowing cornucopia of wished for legal duties.… The implied covenant simply prohibits one party from depriving the other party of its expected benefits under the contract.'
151. *Tymeshare Inc v Covell* 727 F 2d 1145, 1151 (1984). Scalia J stated that the authorities that 'invoke, with increasing frequency, an all purpose doctrine of good faith are usually if not invariably performing the same function executed (with more elegance and precision) by Judge Cardozo in *Wood v Lucy, Lady Duff-Gordon*:' ibid, 1152.
152. [1982] 2 NSWLR 766, 800, relying on the expert evidence of Brietel J, a retired New York judge.
153. Ibid. On appeal to the High Court, McLelland J's observations were referred to with apparent approval by Dawson J in *Hospital Products Ltd v US Surgical Corporation* (1984) 156 CLR 41, 137.

1. *Renard*

Priestley JA, writing extra-curially in 1987, heralded a 'burgeoning maelstrom' threatening to disturb the ostensibly still waters of classical contract theory.[154] By 1993, the storm waters had broken, partly due to Priestley JA's judgment in *Renard*,[155] in which his Honour recognised that a term of reasonableness might be implied to qualify contractual performance. However, since then *Renard* has invariably been cited as authority for an implied term of good faith.[156]

(i) The facts

Renard concerned a dispute between the New South Wales government (the respondent) and a contractor (the appellant) who had undertaken to construct two sewerage pumping stations.[157] The appellant twice requested an extension of the completion date. Following the second request, the respondent exercised its express contractual power to require the appellant to show cause, to the satisfaction of the respondent, why the respondent should not take over the work or cancel the contract. In response, the appellant argued that the respondent had not supplied all the materials it was contractually required to supply. The respondent granted a further extension. However, by the expiration of the extended period the respondent had still not supplied all the required materials, nor had the appellant completed the works.

After a further six weeks the respondent again called upon the appellant to show cause, and eventually served the appellant with a notice stating that the respondent took over the remaining work, and excluded the appellant from the sites. The appellant accepted the respondent's conduct as a repudiation. The dispute was referred to arbitration, where the arbitrator found for the appellant.

(ii) The findings of the arbitrator

The arbitrator made a number of important findings. First, that Mr Connor, the person empowered by the respondent to exercise the 'show-cause' power, formed

154. Priestley above n 7, contending that the 'classical' conception of contract law is giving way at the edges to the ameliorating influences of unconscionability, estoppel, and other equitable concepts, as well as implied terms and notions of good faith and reasonableness.
155. Above n 11. Although credited as the first case to imply a term of good faith and reasonableness, such terms had previously been recognised, albeit in a slightly different context: see eg *Gregory & Bradshaw v MAB* above n 69, 15, where Malcolm CJ stated: 'I have no difficulty in implying an obligation on the part of the respondents to formulate a development proposal in good faith and, acting honestly, to use their best endeavours.'
156. Eg *Alcatel* above n 4, 369, where Sheller JA concluded that following *Renard* above n 11, and *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91, a term of good faith may be implied into contracts in NSW.
157. A standard-form contract (known as NPWC Edition 3 (1981)) was signed in relation to each project.

an unrealistic expectation of the progress that could be expected from the appellant. Secondly, the respondent's failure to make timely delivery of certain materials entitled the contractor to a significant extension of time, a consideration of which Mr Connor was not made aware. Thirdly, Mr Connor had not been advised that by taking over the work it was highly unlikely the work would be completed sooner than if the appellant was allowed to continue. Fourthly, the advice upon which Mr Connor made his decision was prejudicial, as it unfairly indicated the appellant's materials and workmanship were substandard.[158]

In the circumstances, the arbitrator concluded that the respondent's decision to cancel the contract was unreasonable and amounted to a repudiation of the contract.[159] Leave to appeal to the Supreme Court was granted. Cole J upheld the appeal, ruling that the contract contained no implied requirement of reasonableness.[160]

(iii) Priestley JA's judgment

In the Court of Appeal, Priestley JA noted that the clear words of the contract empowered the respondent to issue a 'show-cause' notice upon even the most trivial default by the appellant.[161] His Honour opined that for such a power to be exercisable without any requirement of reasonableness would be to render the contract unworkable.[162] Priestley JA noted that the fundamental purpose of the contract was to have the work done in return for payment, and hence the contract could only have business efficacy if the respondent's powers were subject to a requirement of reasonableness.[163]

His Honour thought the test for the implication of a term of reasonableness in fact could be satisfied, but if not, then such a term equally could be implied in law.[164] In his Honour's opinion, there was nothing novel in the implication of terms into a contract requiring reasonableness by the parties in implementing the terms of the contract.[165]

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158. *Renard* above n 11, Priestley JA 240. The arbitrator found that all criticisms by the respondent of the appellant's workmanship were promptly rectified by the appellant, a fact omitted from the advice provided to Mr Connor.
159. *Renard* ibid, 207.
160. Ibid.
161. Ibid, 258.
162. Ibid.
163. Ibid.
164. Ibid, 256-263. Priestley JA (261) stated that the class of contracts into which the term would be implied could be either the particular standard-form contract used by the parties, or the wider class of contracts 'in which one party promises to build a work of some size for the other party for a price fixed by the contract, which sets out to regulate the carrying out of the contract, and in doing so provides for a number of eventualities…which experience has shown that it is prudent to provide for in advance.' For a discussion of the tests for implication in fact and by law, see below pp 92-96.
165. Ibid, referring to *Meehan v Jones* (1982) 149 CLR 571. Some support may be found for

Priestley JA agreed with the arbitrator's finding that the respondent's conduct was unreasonable and that the respondent's exercise of its power in such circumstances was repudiatory.[166] In broad terms, the respondent's unreasonableness consisted of:

(i) failure to supply the materials the respondent was contractually obliged to supply; and

(ii) failure to obtain the necessary information upon which to base its exercise of discretion.[167]

Priestley JA explained that his conception of reasonableness had much in common with notions of good faith recognised in the United States and cited a number of judicial and academic discussions of good faith.[168] His Honour also referred to the equitable principles by which the courts have interfered in the exercise of legal rights,[169] describing these as 'related' to good faith, notwithstanding that they had hitherto been considered to be separate.[170]

(iv) Meagher JA's judgment

Meagher JA agreed with Priestley JA's conclusion that the respondent had repudiated the contract, but disagreed strongly with Priestley JA's approach. Meagher JA thought it difficult, if not impossible, to ascribe a sensible meaning to 'reasonableness' in this context, as it was not clear by what standard the reasonableness of the respondent's conduct was to be assessed.[171] His Honour concluded that there was 'no possible basis for inflicting such a duty'[172] on the respondent. Instead, Meagher JA construed the requirement that the respondent be 'satisfied' that it should exercise its powers as requiring satisfaction based upon accurate and non-

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that proposition: eg *Lee-Parker v Izzet* [1971] 3 All ER 1099, 1105, where Goff LJ held that the words 'satisfactory mortgage' meant a mortgage that was satisfactory to the purchaser acting reasonably. However, in *Meehan*, there was no clear support for the proposition that a purchaser's decision whether finance was 'satisfactory' had to be reasonable. Mason J (591) suggested that the decision must be made 'honestly', or 'honestly and reasonably', but expressly did not decide which of the two formulations was to be preferred. Wilson J (598) agreed, but appeared to favour mere honesty. Gibbs CJ (581) expressly declined to apply a test of reasonableness, as did Murphy J (597).

166. *Renard* ibid, 260. Priestley JA drew a number of conclusions: the US developments grew from the same common law source as that of Australian law; academic stimulus encouraged the common law to extrapolate from specific statutory good faith provisions; imprecision in the definition of good faith had not impeded its adoption in a highly commercial society; and there was no indication that the adoption of a good faith standard had impinged on the efficacy of US contract law.
167. Ibid, 240.
168. Ibid, 267-268.
169. Discussed above pp 73-77.
170. *Renard* above n 11, 263-269.
171. Ibid, 275.
172. Ibid.

prejudicial information.[173] His Honour considered that the respondent was 'so distorted by prejudice and misinformation that he was unable to comprehend the facts in respect to which he had to pass judgment'.[174]

Accordingly, Meagher JA found that the respondent was not 'satisfied', and its purported exercise of its powers to take over the work amounted to a repudiation.[175]

(v) Analysis of Priestley JA's decision

Although not relied upon by Priestley JA (or Meagher JA), the first ground of unreasonableness identified, that of the failure to supply the materials, could also be categorised as a breach of the express term of the contract requiring the respondent to supply the materials. Indeed, given the conduct consisted of non-compliance with a contractual obligation to do a certain act, it would also fall squarely within the implied obligation of a party to do 'all such things as are necessary on his part to allow the other party to have the benefit of the contract', derived from *Butt v M'Donald*.[176]

The principal's unreasonableness in failing to obtain the necessary information upon which to exercise its discretion appears to go further than the obligation to do 'such things as are necessary'.[177] However, the respondent's decision to exercise its power on the basis of inadequate information, or without attempting to form an accurate view of the facts, could properly be described as arbitrary,[178]or capricious,[179] in the same way that the courts have held that a vendor of land, in seeking to rescind, 'must not act arbitrarily, capriciously, or unreasonably'.[180] Although referring to these principles in his explanation of what he meant by reasonableness, and citing *Godfrey Constructions*, Priestley JA confined the basis of his decision to the novel implied term of reasonableness.[181]

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173. Ibid, 276.
174. Ibid, 275.
175. Ibid, 276.
176. Above n 37, 70-71, following *Mackay v Dick* above n 35. The breach in *Mackay v Dick* consisted of one party's refusal to allow a machine which it had commissioned to be tested as required under the contract, instead declaring it inadequate and terminating the contract prematurely.
177. *Australis* above n 43, 124, holding that the obligation attached only to things which the contract expressly required to be done.
178. 'Arbitrary' is defined to mean 'subject to individual will or judgment; discretionary,' and also 'capricious, uncertain, unreasonable': *The Macquarie Dictionary* 3rd edn (1997).
179. 'Caprice' is defined as 'a sudden change of mind without apparent or adequate motive; whim': *Macquarie Dictionary* ibid.
180. *Pierce Bell Sales v Frazer* above n 37, Gibbs J 590, quoting Radcliffe VC in *Selkirk v Romar Investments Ltd* [1963] 1 WLR 1415, 1422-1423. Interestingly, Gibbs J (592-593) also recognised an implied obligation on the part of the respondent to render the contract efficacious. The respondents breached this obligation, but the appellants, having 'met unreasonableness with unreasonableness', were not entitled to a remedy.
181. *Renard* above n 11, 271.

While it does not necessarily follow that Priestley JA should have based his decision on other grounds, it does appear that the result in *Renard* is readily reconcilable with traditional controls over contractual performance.

2. *Burger King v Hungry Jack*'s

Burger King is the most recent appellate court decision to have recognised an implied term of good faith, and, more significantly, to have found that term to have been breached.[182]

(i) The facts

The litigation concerned a protracted dispute between the appellant, the franchisor of a fast food chain, and the respondent, the largest franchisee of the chain in Australia. The relationship between the parties, which had for some years been acrimonious, was governed by a web of agreements, including the Development Agreement. That agreement conferred on the respondent an obligation to develop, and obtain franchisees for, at least four restaurants per year in certain States. In relation to each restaurant the respondent was required to obtain from the appellant operational, financial and legal approval.

The appellant, relying on a number of minor breaches of operational procedures by the respondent and its franchisees, withheld operational and financial approval of a number of restaurants. The appellant also placed a 'freeze' on the respondent's ability to recruit franchisees. These events caused the respondent to default on its obligation to develop new restaurants, which the appellant relied on in purporting to terminate the contract.[183]

(ii) At first instance

The respondent alleged that the Development Agreement contained the following terms:

(i) the appellant would do all that was necessary to enable the respondent to enjoy the benefits of the contract;[184]

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182. The result of that finding was spectacular, Hungry Jack's (the respondent) being awarded over $70 million in damages (revised to $50 million on appeal). Special leave to appeal to the High Court was granted, although not on grounds relating to good faith or the implication of terms. The matter settled before argument was heard in the High Court.
183. The respondent also alleged that the appellant had breached fiduciary duties owed in relation to a separate agreement entered into jointly by the appellant and the respondent with Shell Oil Co to investigate the opening of restaurants at Shell's service stations. The appellant, without the respondent's knowledge, subsequently entered into a bi-lateral arrangement with Shell, to the exclusion of the respondent.
184. Described by Rolfe J and the parties as the implied 'term of reasonable co-operation": *Hungry Jack's v Burger King* [1999] NSWSC 1029, para 448.

(ii) the appellant must act reasonably in exercising its contractual powers; and

(iii) the appellant was obliged to act in good faith in the exercise of its contractual powers. [185]

Rolfe J found that even before the dispute, the appellant was seeking to strengthen its market position by becoming directly involved in the development and operation of restaurants, and that the appellant, at various times, considered buying out the respondent, or otherwise wresting control of the respondent's operations.[186]

Rolfe J found the appellant's withholding of approval and implementation of the 'freeze' constituted breaches of either the implied terms of co-operation, reasonableness or good faith.[187] Rolfe J thought there could be no doubt that a term of co-operation was to be implied.[188] By contrast, Rolfe J stated that although he was bound by *Renard* to imply terms of reasonableness and good faith, he was uncertain of the precise juridical justification for such implications.[189]

His Honour proceeded to find that the appellant's conduct was unreasonable, though he noted that such a finding was strictly unnecessary, as the same conduct constituted breaches of the express terms of the contract, and of the implied terms of co-operation.[190]

(iii) The Court of Appeal

The appellant conceded that the agreement was subject to an implied term of co-operation, but disputed the existence of the implied terms of good faith and reasonableness, and denied being in breach of any of the implied terms.[191]

In a unanimous judgment, the court referred to Priestley JA's discussion of good faith and reasonableness in *Renard*,[192] reiterating his Honour's acknowledgment of

185. *Burger King* above n 4, para 141.
186. Ibid, paras 31-33.
187. *Hungry Jack's v Burger King* above n 184, Rolfe J para 448.
188. Ibid, para 426.
189. Ibid, para 431. See also para 432 where Rolfe J doubted that a term of good faith or reasonableness was capable of clear expression.
190. Ibid, para 454.
191. *Burger King* above n 4, para 143.
192. Ibid, para 146. Their Honours then explained: '[w]e have referred and relied extensively upon his Honour's judgment in so far as it deals with an implied obligation of good faith, as it provides, obiter, authoritative background to the development of the law on this issue': ibid, para 154. The qualifier 'in so far as it deals with an implied obligation of good faith' perhaps suggests that Sheller and Beasley JJA had resiled somewhat from Sheller JA's robust conclusion in *Alcatel* (above n 4, 369) (with which Beasley and Powell JJA agreed), that *Renard* above n 11 and *Hughes Bothers* above n 156 meant that a duty of good faith may be imposed on parties to a contract.

the 'well documented Australian experience' of restraining the use of rescission clauses to prevent their use 'for improper and extraneous purposes'.[193]

Their Honours proceeded to discuss the Australian authorities dealing with the implied term of good faith,[194] concluding that recent case-law demonstrated that obligations of good faith and reasonableness will be implied most commonly into standard form contracts, particularly those containing termination clauses.[195] However, their Honours noted that the implied terms were not limited to such contracts.[196]

In relation to the Development Agreement, their Honours were of the opinion that the enjoyment of the rights conferred by the contract would 'be rendered nugatory, worthless or, perhaps, seriously undermined' if the appellant's power to grant or refuse approval was to be completely unfettered.[197] That conclusion was said to be based upon the agreement's extraordinary range of detailed considerations (both subjective and objective), which effectively operated as conditions precedent to the appellant's grant of approval. Accordingly, unless the implied terms were recognised, the appellant 'could, for the slightest of breaches, bring to an end the very valuable rights which [the respondent] had under the Development Agreement'.[198]

The court upheld the decision of Rolfe J, finding that the appellant's contractual powers were to be exercised in good faith and reasonably.[199] Their Honours did not attempt to define the precise content of these obligations, but stated that the imposition of such a fetter –

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193. *Burger King* ibid, para 151, referring to *Godfrey Constructions* above n 79, 548; and *Pierce Bell Sales v Frazer* above n 37, 587, discussed above pp 66-77.
194. *Burger King* ibid, paras 151-162, referring to *Renard* above n 11*; Alcatel* above n 4; *Hughes Bros* above n 156; *Service Station v Berg Bennett* above n 1; *Far Horizons v McDonald's* above n 4; *Garry Rogers Motors v Subaru* above n 4; *Saxby Bridge Mortgages Pty Ltd v Saxby Bridge Pty Ltd* [2000] NSWSC 433; *Asia Television Ltd v Yau's Entertainment Pty Ltd* (2000) 48 IPR 283.
195. *Burger King* above n 4, para 163.
196. Ibid.
197. Ibid, para 177, quoting *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, McHugh and Gummow JJ 448.
198. *Burger King* ibid, para 183. It is not clear whether the Court thought that this aspect of the contract attracted the implied terms, or whether this was a factual matter evidencing the necessity of the implication of a term of good faith and reasonableness. In *Commonwealth Bank of Australia Ltd v Spira* (2002) 174 FLR 274, 300, Gzell J identified a 'difficulty' in the *Burger King* judgment in so far as the Court there proceeded to examine whether a clause ought to be implied in the particular contract, a process more appropriate to implication in fact. However, as Gzell J himself noted (298-299) when a court first decides whether a term should be implied by law into a particular class of contract, it does so on the basis of necessity, which must be determined after discussion of whether the term ought to be implied.
199. *Burger King* ibid, para 185.

> does not mean that [the appellant] is not entitled to have regard only to its own legitimate interests in exercising its discretion. However, it must not do so for a purpose extraneous to the contract – for example by withholding financial or operational approval where there is no basis to do so, so as to thwart [the respondent's] rights under the contract.[200]

The court supported this proposition by reference to a number of the US cases discussed above, in Part II.[201]

Having recognised the pleaded implied terms, the court upheld Rolfe J's finding that the appellant's conduct constituted a breach of those terms.[202] The court found that the appellant's 'freezing' of the respondent's ability to recruit third party franchisees forced the respondent into default of the Development Agreement, and was done in furtherance of an improper purpose, namely weakening the respondent's position in the market.[203] The court also agreed with Rolfe J's assessment that there was no reasonable basis on which the appellant could refuse consent to the recruitment of new franchisees.[204]

Similarly, the court found that the appellant's refusal of financial approval to the respondent was not in furtherance of the appellant's legitimate rights under the contract. Their Honours agreed with Rolfe J's conclusion that this conduct was –

> in pursuance of a deliberate plan to prevent [the respondent] from expanding, and to enable [the appellant] to develop the Australian market unhindered by its contractual arrangements with [the respondent].[205]

Moreover, there was no basis on which the appellant could legitimately refuse to grant financial approval. Hence, on-going withholding of approval constituted a breach of the implied term of good faith.[206]

The third breach of the obligations of good faith and reasonableness that the court identified was the refusal to grant operational approval, which the appellant justified on the grounds that a certain percentage of the respondent's restaurants breached minimum presentation and hygiene standards. The court found the appellant had failed to comply with its own restaurant inspection requirements, and so was unable accurately to determine whether the respondent's restaurants were below standard.[207]

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200. Ibid.
201. Ibid, para 173, referring to *Kham & Nate's Shoes (No 2)* above n 138; *Metropolitan Life Insurance v Nabisco* above n 140; *Rio Algom v Jimco* above n 140.
202. *Burger King Corp* ibid, paras 223-224.
203. Ibid, para 223.
204. Ibid, para 224.
205. Ibid, para 310.
206. Ibid, para 308.
207. Ibid, para 343.

Accordingly, the appellant was either in 'breach of the implied obligation of co-operation, or alternatively, was in 'breach of the implied obligation of good faith'.[208]

(iv) Analysis of the Court of Appeal's judgment

The court found that the appellant was not authorised by the contract to 'freeze' the respondent's ability to recruit third party franchisees. To continue to do so could, therefore, be characterised as hindering the fulfilment of the express terms of the contract. Alternatively, absent an express term of the contract enabling the respondent to enforce the freeze, the appellant was in breach of its implied obligation to do such things (in this case, to grant approval) as were necessary for the respondent to have the benefit of the contract.

The third breach, in relation to withholding operational approval, seems similarly explicable. As the court explicitly recognised, what was characterised as a breach of good faith could also be seen as a failure to co-operate in the carrying out of its inspection requirements, breaching the implied term of co-operation.[209]

The appellant's second breach, refusing to grant financial approval, also lacked contractual justification, and like the conduct considered above, could therefore be seen to constitute a breach of the implied obligation to co-operate. Additionally, the court emphasised that the decision to withhold approval had been motivated by an improper, and extraneous, purpose. Had the appellant been able to identify a contractual right or power enabling it to continue to withhold approval, then arguably the court could have applied the traditional equitable principles utilised in *Godfrey Constructions* to prevent the appellant's improper actions.

It is not suggested that the results reached by the courts in *Renard* or *Burger King* were inappropriate. To the contrary, the appropriateness of the results of those cases is evidenced by the fact that the same results could have been reached by application of principles long established in Australian law. It seems that the content of the implied terms of good faith and reasonableness, and the results wrought by their hitherto cautious application, vary little from the implied obligation of co-operation. Further, the purpose of implying those terms appears similar to the purpose for which the courts have, in their equitable jurisdiction, restricted the exercise of contractual power: to prevent the furtherance of an improper or extraneous purpose.

IV. POTENTIAL AREAS OF DIVERGENCE OF GOOD FAITH FROM CO-OPERATION

In the previous Part, it was suggested that the results of the use of good faith and reasonableness in the recent Australian case-law have, so far, adhered closely to

208. Ibid.
209. Ibid, para 343; see also *Hungry Jack's v Burger King* above n 184, Rolfe J para 450.

long established methods of regulating contractual performance. Yet some commentators have argued that the implication of terms of good faith and reasonableness has the unrealised potential to disrupt Australian contract law and commercial behaviour.[210] This Part examines that proposition by considering some further specific aspects of the obligation of good faith.

1. Source of the obligation of good faith

In Australia, the absence of a UCC-style statutory obligation[211] has meant that the courts have approached good faith as a term which may be implied into contracts, either in fact, or as a legal incident of the contract.[212]

(i) Implication in fact

The implication of a term in fact (or 'ad hoc') allows the courts to fill contractual 'gaps' created by the silence of the contract on a particular subject, and is premised on the courts' inferences as to the actual intentions of the parties.[213] The modern test for implication in fact was enunciated in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*, where the Privy Council held that for a term to be implied it must:

(i) be reasonable and equitable;
(ii) be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
(iii) be so obvious as to go without saying;
(iv) be capable of clear expression; and
(v) not contradict any express term.[214]

This rigorous test has been used by some courts to determine whether a term of good faith may be implied in a particular contract.[215] For example, in *Saxby Bridge*

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210. See generally Carlin above n 6, 102, arguing that implied terms of good faith create intolerable uncertainty. Cf French J in *Bropho v HREOC* above n 9, 785.
211. See discussion above pp 80-81.
212. In *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, 487, Hope JA suggested that the distinction between implication in fact and by law had not been, and was still not, universally appreciated, and that there may be a degree of overlap between the two methods of implication. Cf *Breen v Williams* (1996) 186 CLR 71, Gaudron & McHugh JJ 103.
213. The implication of terms is referred to in the US as 'gap-filling': TD Rakoff 'The Implied Terms of Contracts: Of "Default Rules" and "Situation Sense"' in Beatson & Friedman *Good Faith and Fault in Contract Law* above n 22, 191. Rakoff notes also that implied terms have become known in the US as 'default rules', a phrase suggestive of the role of implication by law in Anglo-Australian contract law.
214. *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 (*BP Refinery*), Lord Simon of Glaisdale 283, speaking on behalf of the Privy Council. This test was applied in *Codelfa Construction* above n 33, Mason J 347.
215. Eg *Advance Fitness Corporation Pty Ltd v Bondi Diggers Memorial and Sporting Club Ltd* [1999] NSWSC 264, Austin J paras 121-122, finding that no such term could be implied. Cf

Mortgages Pty Ltd v Saxby Bridge Pty Ltd,[216] Simos J refused to imply a term of co-operation or good faith in fact, on the basis that such a term was neither necessary nor obvious.[217] In addition, it will usually be possible for at least one party to assert that the contract is effective without the implied term,[218] and it may also be argued that a term of good faith is not readily capable of clear expression.[219]

English courts appear to be more willing to recognise a term implied in fact. In *Equitable Life Assurance Society v Hyman*,[220] Lord Steyn, on behalf of the House of Lords, implied a term preventing the directors of a pension society from exercising their discretion to determine the bonuses payable under a pension policy for an extraneous purpose.[221] His Lordship thought that it was 'certainly not a case in which a term can be implied in law', but found that such a term could be implied in fact. However, His Lordship expressed the test simply as one of 'strict necessity' and did not refer to the other considerations adumbrated in *BP Refinery*.[222]

A similarly sanguine approach was adopted by the English Court of Appeal in *Paragon Finance Plc v Staunton*.[223] Dyson LJ recognised an implied term that a mortgagor's discretion to vary interest rates should not be exercised improperly, capriciously or arbitrarily,[224] based upon his Lordship's conclusion that such an implication was necessary to protect the legitimate expectations of the mortgagee.[225]

Hughes Aircraft Systems International v Airservices Australia above n 4, Finn J 32, finding that a term could be implied in fact or in law (36-42), albeit in the context of a tender process, which falls outside the scope of this article.

216. Above n 194.
217. Ibid, paras 62-64.
218. *Renard* above n 11, Priestley JA 261; *Central Exchange v Anaconda Nickel* above n 4, Steytler J 50; Peden, above n 60, 224.
219. Eg *Hungry Jack's v Burger King* above n 184, Rolfe J para 432: 'It is difficult to see how, consistently with [the principles relating to the implication of terms], one can imply a general term of "reasonableness". Meaning and content can only be given to that word by a judicial assessment, which may not match that of the contracting parties as to what is "reasonable", and which certainly may not be capable of clear expression'.
220. Above n 98.
221. Ibid, Lord Steyn 971.
222. Ibid, Lord Steyn 970.
223. [2002] 1 WLR 685.
224. Ibid, 260-261. His Lordship held that the implication was necessary to give effect to the expectations of the parties, a finding which appeared to rest more on reasonableness than necessity. His Lordship stated that he could not accept that the mortgagor's power was completely unfettered: 'If that were so, it would mean that the claimant would be completely free … to specify interest rates at the most exorbitant levels': ibid, 260. See also *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] EWCA Civ 1047, Mance LJ para 73, implying a term that a discretion be exercised, inter alia, in good faith and after due consideration, was justified as a matter of necessity, and to give the contract efficacy, but without any consideration of how such a term was necessary.
225. *Paragon Finance v Staunton* ibid, 261.

In Australia, however, the High Court has regularly endorsed the more onerous *BP Refinery* test.[226] In view of the difficulty in complying with this test, Australian courts have tended to approach the question of whether an obligation of good faith is to be implied as one of implication by law.[227]

(ii) Implication by law

A term is implied by law where the courts consider that the imposition of a particular obligation in a particular class of contracts[228] is necessary to prevent 'the enjoyment of the rights conferred by the contract' from being 'rendered nugatory, worthless, or, perhaps, be[ing] seriously undermined'.[229]

The meaning of 'necessary' in this context is not entirely clear.[230] In *Renard,* for example, Priestley JA pointed out that if necessity in the absolute sense is required, then terms could only be implied where the contract would not work without them.[231] His Honour thought the better interpretation that 'necessity has the sense of something required in accordance with current standards of what ought to be the case, rather than anything more absolute'.[232]

(iii) Construction of the contract

Some commentators have suggested that good faith is properly a canon of construction.[233] For example, Peden argues that courts ought to construe the express terms of the contract as requiring their exercise in good faith,[234] on the basis of the

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226. *Codelfa Construction* above n 33, Mason J 347; *Hospital Products v US Surgical Corp* above n 152, Gibbs CJ 66; *Breen v Williams* above n 212, Gaudron & McHugh JJ 103. However, where the contract under consideration is incomplete or informal, the court will ask only whether the term is necessary for the reasonable or effective operation of the contract in the circumstances of the case: *Byrne v Australian Airlines* above n 197, Brennan CJ, Dawson & Toohey JJ 422, citing *Hawkins v Clayton* (1988) 164 CLR 539, Deane J 573.
227. *Garry Rogers Motors v Subaru* above n 4, Finkelstein J 43,014; *Burger King* above n 4, para 223; *Central Exchange v Anaconda Nickel* above n 4, Steytler J 50; *Vodafone* above n 4, Giles JA para 189.
228. *Liverpool City Council v Irwin* [1977] AC 239, Lord Wilberforce 255, citing Bowen LJ in *Miller v Hancock* [1893] 2 QB 177, 180-181. A term implied in law may originate from a term first implied in fact, which subsequently becomes incorporated into the common practice of contracting parties: *Byrne v Australian Airlines* above n 197, McHugh & Gummow JJ 449.
229. *Byrne Australian Airlines* ibid, McHugh & Gummow JJ 450.
230. *Castlemaine v Carlton* above n 61, Hope JA 489-490, who observed that it was not clear what the test was or whether there was more than one test.
231. *Renard* above n 11, 261.
232. Ibid, referring to Oliver Wendell Holmes Jr's phrase: 'The felt necessities of the time'.
233. An early argument along these lines was made by Burrows above n 53.
234. E Peden 'Contractual Good Faith: Can Australia Benefit from the American Experience?' (2003) 15 Bond LR 186, 199; Carter & Peden above n 5, 162; E Peden 'The Meaning of

argument that notions of good faith inhere in all contract law principles.[235] According to Peden, incorporating good faith by construction is preferable to implication because there would then be no question as to whether good faith applies.[236] Peden further criticises implication on the ground that it perpetuates the use of legal fictions.[237]

However, the construction approach may itself tend to stray into fiction insofar as it assumes that contracting parties intend all rights and obligations to be exercised in good faith and reasonably. In practice, commercial parties may intend that an express right is to be exercised according to the unrestrained discretion of one or other of the parties. The virtue of implication by law is that it acknowledges that it is the law, not the parties, that considers the obligation to be necessary. This distinction was recognised by Giles JA in *Vodafone*, where his Honour described 'implication' as:[238]

> A preferable use of language, since it recognises that the obligation is imposed by law – because the term is implied in law – and does not proceed on a fiction that an intention of the parties is being found by a process of construction.[239]

Although the construction approach has been referred to by some courts,[240] implication by law is the favoured method of incorporating obligations of good faith, whether in contracts of a particular class,[241] or, as some courts have held, in all commercial contracts.[242] As such, the source of the obligations of good faith and

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Contractual "Good Faith"' (2002) 22 ABR 235, 247; E Peden 'The Mistake of Looking for Legislative Influence in Contractual Good Faith' (2002) 16(4) CLQ 20, 22; Peden above n 60, 232-238; Peden above n 5. The recurrent arguments in the above articles are collected and expanded upon in Peden above n 56 (see especially Part 6 of the book).

235. As was argued in Carter & Peden above n 5, 158-162. Similar comments were made by Mason above n 13.

236. Peden considers there are no terms implied in all contracts: Peden above n 60, 230. However, a century ago Giffith CJ recognised a general implication, in every contract, that each party agrees to do all such things as are necessary to enable the other party to have the benefit of the contract: *Butt v M'Donald* above n 37, 70-71. Some decisions suggest that good faith may also be implied in all contracts; eg *Garry Rogers Motors v Subaru* above n 4, Finkelstein J 43,014; *Overlook v Foxtel* above n 4, Barrett J 91,970.

237. Peden above n 56, 14-15.

238. *Vodafone* above n 4, para 206. Giles JA was strongly critical of Einstein J's decision at first instance, both generally, and particularly in relation to His Honour's reliance on Peden's construction approach: para 220 ff.

239. Ibid. See also *Byrne v Australian Airlines* above n 197, McHugh & Gummow JJ 449 stating that implication is the 'modern and better' approach.

240. Eg *Central Exchange v Anaconda Nickel* above n 4, Steytler J 50; *Overlook v Foxtel* above n 4, Barrett J 91,970.

241. *Renard* above n 11, 261; *Hughes Aircraft v Airservices Australia* above n 4, Finn J 38; *Burger King* above n 4, para 163, referring to standard form contracts. However, the court proceeded to imply such a term in law, notwithstanding that the particular contract was not within any of the traditional classes of contract into which a term will be implied (para 166).

242. *Garry Rogers Motors v Subaru* above n 4, Finkelstein J 43,014; *Overlook v Foxtel* above n 4, Barrett J 91,970. Cf *Vodafone* above n 4, Giles JA para 189.

co-operation appears to be similar, although the source of the obligation of co-operation has not received the same level of scrutiny as good faith.

2. Exclusion of the implied term of good faith

Even if the content and source of the obligation of good faith vary little from the standards set by more familiar principles, the impact of such a term would be significantly enhanced if contracting parties were unable to modify or exclude the term.

(i) A mandatory term?

The authors of the Australian edition of Cheshire and Fifoot's *Law of Contract* posit that good faith operates as a universal term which, unlike conventional implied terms, ought not be disclaimable.[243] Such a 'term' would, in truth, be a rule of law, and would represent a significant extension of the restraints on commercial behaviour traditionally imposed by the courts. As Finn J noted in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*,[244] the common law does not recognise any method of imposing contractual obligations on parties other than express or implied terms:

> We do not have the facility, for example, to treat the duty as simply a mandatory rule of contract law as do many European legal systems.[245]

If good faith is to be a mandatory standard in all contracts, judicial innovation will be required, not in terms of the content of the obligation, but in the method of its implementation.[246] The important questions of policy that will attend such a decision have been raised only under the rubric of implied terms. For example, in *Commonwealth Bank of Australia v Spira*, Gzell J stated that:

> If as a matter of general policy a term is to be implied by law in all contracts of a particular class, public policy should not, in my view, countenance any exclusion of the term from contracts within the class.[247]

His Honour considered that if the imposition of a term is adjudged 'necessary' to that class of contracts, then that term, as an instrument of public policy, ought not

243. Seddon & Ellinghaus above n 13, 430-431, apparently conceiving of a separate category of implied term: the 'universal term', which the authors suggest could not be completely excluded, may be limited in ambit by the express terms of the contract.
244. (2003) 128 FCR 1.
245. Ibid, Finn J 208.
246. Although the common law rarely prescribes mandatory standards of conduct, such standards are occasionally set by the legislature; eg the proscription of misleading or deceptive conduct (TPA s 52; Australian Securities and Investment Commission Act 2001 (Cth) s 12); and of unconscionable conduct (TPA Pt IVA).
247. *Commonwealth Bank v Spira* above n 198, 300. An appeal from Gzell J's judgment was heard and dismissed by the Court of Appeal without reference to good faith: *Spira v Commonwealth Bank* above n 4.

be easily cast aside.[248] Finn J also has argued that party autonomy notwithstanding, there are invariable standards that should be imposed on contracting parties.[249]

Certainly, mandatory standards are not unknown to the common law. For example, in administrative law the requirement of good faith cannot be excluded by even the most draconian of ouster clauses.[250] However, the relationship of contracting parties is antithetical to the typically unilateral administrative relationship. Moreover, administrative power may only be exercised for the public good and not for partisan or self-interested purposes.[251] That restraint is imposed because the source of administrative power is the people.[252] Accordingly, the exercise of power for partisan or self-interested purposes will usually fall outside the grant of power.[253]

By contrast, the source of a contractual power is the will of the parties, as manifested in the contract. Contracting parties may contemplate that a contractual power or discretion will be exercised self-interestedly, especially when restraints on that power have expressly, or impliedly, been disclaimed.

It is suggested that the issue is not, as Finn J has suggested, simply doctrinal,[254] and that the commercial context in which this debate will play out must be kept firmly in mind. Thus, although there are strong arguments for entrenching mandatory standards in consumer contracts,[255] commercial contracts are likely to be the product of extensive negotiation and advice, representing an allocation of risks and interests too nuanced to be reconciled with a general, mandatory obligation of good faith or reasonableness.[256] Indeed, while it has been suggested that it is likely that attempts to exclude good faith would be regarded as signalling an intent to perform in bad

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248. *Commonwealth Bank v Spira* ibid.
249. Finn J cited various international instruments which contained such a mandatory standard of good faith: Finn above n 6, 417; and in *GEC Marconi* above n 244, 208, referring to UNIDROIT's Principles of International Commercial Contract; the Commission on European Contract Law's Principles of European Contract Law; and the UCC.
250. Eg *R v Hickman; Ex parte Fox and Clinton* (1945) 70 CLR 598, Latham CJ 606-607. More recently, the requirement of good faith in administrative law has been comprehensively examined by French J in *WAFV v Refugee Review Tribunal* (2002) 125 FCR 351, 366-373.
251. *Three Rivers District Council v Bank of England* (No 3) [2003] 2 AC 1, Lord Steyn 190.
252. *Hot Holdings Pty Ltd v Creasy* (2002) 210 CLR 438, Kirby J 468.
253. Ibid.
254. *GEC Marconi* above n 244, 209.
255. See eg TPA s 68, which renders void any attempt to exclude or limit the implied warranties (eg, as to merchantable quality) in TPA Pt V Div 2. The policy imperatives that led Parliament to entrench implied warranties in consumer transactions do not apply equally to all commercial contracts. Disparity of bargaining power, resources and information are typical of consumer transactions. However, such inequalities do not necessarily exist in commercial contracts, which are usually the product of negotiation, consideration and professional advice.
256. For comments to this effect, see *GSA Group v Siebe* above n 4, Rogers CJ 580*; Austotel v Franklins* above n 32, Kirby P 586.

faith, and therefore be commercially injurious,[257] in a sophisticated commercial context both parties are just as likely to want to exclude good faith in order to limit their exposure to unforeseen obligations and restrictions.

The courts too, may be more willing to embrace an optional standard than a mandatory one. In the United States, UCC clause 1-102(3) attempts to ensure that the implied covenant of good faith is treated as a mandatory rule of the kind referred to by Finn J, providing that good faith may not be excluded from contracts of sale.[258] However, as Farnsworth has noted, Anglo-American law does not ordinarily endorse mandatory rules not agreed to by the parties, and hence:

> The obligation of good faith performance and the terms implied under it will be more appealing and more likely of extension if they are more readily subject to modification by agreement than is suggested by the [UCC] section on variation by agreement.[259]

While the judicial treatment of this section has been equivocal,[260] there is a clear body of authority in support of the proposition that parties may exclude the implied covenant of good faith.[261]

One cannot quarrel with Finn J's observation that there are 'real questions still to answer'[262] as to whether, and when, good faith may be excluded. However, the current wisdom appears to be that good faith, like all implied terms, may be excluded by express words, or by inconsistency with the express terms of the contract.

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257. D Magarey & N Seddon 'Good Faith in Commercial Contracts – An Accepted Idea?' (2004) 4 The Issues 22, 23.
258. Given that these provisions of the UCC apply only to contracts of sale, the policy considerations which inform them may be closer to those informing the implied warranties in the TPA than to the common law approach to freedom of contract.
259. Farnsworth above n 8, 678.
260. See the authorities cited in T Diamond & H Foss 'Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery' (1996) 47 HSTLJ 585, 625, nn 188-189.
261. Eg *Tymshare v Covell* above n 151, where Scalia J observed: 'It is possible to so draw a contract as to leave decisions absolutely to the uncontrolled discretion of one of the parties and in such a case the issue of good faith is irrelevant.' *Patel v Dunkin' Donuts of America Inc* 496 NE 2d 1159, 1160 (1986), Murray J: 'A covenant of good faith and fair dealing is implied in every contract as a matter of law, absent an express provision to the contrary'. *Super Valu Stores Inc v D-Mart Food Stores Inc* 431 NW 2d 721, 726 (1986), Eich J: 'It would be a contradiction in terms to characterize an act contemplated by the plain language of the parties' contract as a 'bad faith' breach of that contract'. The Australian position seems similar: *Pacific Brands Sport v Underworks* above n 16, Finklestein J 88,498.
262. *GEC Marconi* above n 244, 209. One such question is whether the exclusion of a requirement to perform in good faith would render the contract illusory: Heffey, Patterson & Robertson above n 63, 271. See discussion above p 72.

(ii) Express exclusion

It has been said that implied terms begin where the intentions of the parties leave off and the law steps in.[263] However, the law will not step in where it is clearly not welcome. Thus an express provision excluding implied terms is likely to be effective to prevent terms being implied in the agreement, whether in fact or by law.[264]

However, the words used and the intended result must be clear,[265] and courts have differed in their evaluation of the level of specificity required to prevent an implication of good faith. In *NT Power Generation Pty Ltd v Power and Water Authority*,[266] Mansfield J held that a clause rendering the written contract the 'entire agreement' between the parties was sufficient to prevent the implication of a term of good faith.[267] This conclusion was based on *Hope v RCA Photophone of Australia Pty Ltd*,[268] where Dixon J upheld the efficacy of a 'whole agreement' clause to exclude an implied term.[269] However, the clause in *Hope* specifically excluded implied warranties, understandings, or agreements, and as such, was substantially more precise than the clause in issue in *NT Power*.

The finding in *Hope* may be contrasted with the earlier decision in *Hart v MacDonald*, where the High Court implied a term of co-operation despite a clause stating that there was no agreement or understanding between the parties not embodied in the contract.[270] The court appears to have construed the clause literally, explaining that an implied term is, as a matter of law, embodied in the parties' agreement and therefore is unaffected by the entire agreement clause.[271]

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263. Seddon & Ellinghaus above n 13, para 10.39, cited with apparent approval by Giles JA in *Vodafone* above n 4, para 206.
264. *Vodafone* ibid, para 201. Such a term would prevent implication in fact, as the implied term would clearly be inconsistent with the express terms of the contract, which is one of the tests mentioned in *BP Refinery*: see discussion above pp 93-96.
265. Eg *Duncombe v Porter* (1953) 90 CLR 295, Fullagar J 311: 'Rights which exist at common law or by statute are not to be regarded as denied by words of dubious import'; Dixon CJ 306.
266. (2001) 184 ALR 481, upheld on appeal without reference to the point: *NT Power Generation v Power & Water Authority* (2002) 122 FCR 399. An appeal to the High Court has been heard and allowed, although the Federal Court's finding on this point was not an issue: *NT Power Generation v Power & Water Authority* (2004) 219 CLR 90.
267. *NT Power* (2001) ibid, 571. Cf *GEC Marconi* above n 244, Finn J 208-209.
268. (1937) 59 CLR 348.
269. Ibid, Dixon J 363. The appellant alleged an implied term in a sales contract that the specified goods to be sold to the appellant should be new, and not used. Although Dixon J held that the term had been effectively excluded in the instant case, his Honour refused to hold that such a term could never be implied. See also Latham CJ 357, Rich J 358.
270. *Hart v MacDonald* (1910) 10 CLR 417, Griffith CJ 421; O'Connor J 427; Isaacs J 430-431.
271. Ibid, 427, O'Connor J holding that: '[e]very implication which the law makes is embodied in the contract just as effectively as if it were written there in express language'. Similarly, Isaacs J held that the effect of the clause was to exclude what was extraneous to the contract, not implications arising from the proper construction of the contract. However,

Ultimately, whether an attempt to exclude the obligation is effective will depend upon whether the court can discern a clear intention of the parties to exclude the obligation. For example, in *Vodafone* (the most recent discussion of the issue), Giles JA thought that a clause in the following terms clearly manifested such an intention: 'To the full extent permitted by Law and other than as expressly set out in this Agreement the parties exclude all implied terms',[272] suggesting that general words may be effective to exclude terms implied by law, including terms of good faith.

(iii) Inconsistency with express terms

Notwithstanding the erosion of freedom of contract in recent years, primacy is still given to the intentions of the parties, construed objectively.[273] Accordingly, a term will not be implied where it is in conflict with the intentions of the parties, manifested in the contract.[274] In such circumstances 'the introduction into [the parties'] contract of a further implied term … is likely to do violence to their contractual intentions rather than give effect to them'.[275]

The inconsistency of an implied term with the express terms will prevent its implication in fact,[276] whereas the presence of express terms inconsistent with a term otherwise implied in law will exclude the implied term from the particular contract, though not from all contracts of that class.[277]

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his Honour did consider that a 'definite exclusion' might have the effect of excluding a term that would otherwise form part of the contract by implication: ibid 430.

272. *Vodafone* above n 4, para 201. Giles JA rejected the approach taken at trial by Einstein J, that as terms implied in law are attributed to the presumed intentions of the parties, they should therefore be considered express, although unwritten, provisions of the contract. This approach appears to be drawn from the comments of O'Connor J in *Hart v MacDonald* above n 270, 427, to the effect that implied terms are as much part of the contract as the express terms. Einstein J's literal interpretation of O'Connor J's comments was rejected by Giles JA, but not discussed in detail.

273. *Wilson v Anderson* (2002) 213 CLR 401, Gleeson CJ 418, who observed: 'The law of contract seeks to give effect the common intention of the parties to a contract. But the test is objective and impersonal. The common intention is to be ascertained by reference to what a reasonable person would understand by the language used by the parties to express their agreement. If the contract is in the form of a document, then it is the meaning that the document would convey.' *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451, 461-462; *Taylor v Johnson* (1983) 151 CLR 422, Mason ACJ, Murphy & Deane JJ 429; *ABC v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540, Gleeson CJ 549.

274. *Devefi v Mateffy Pearl Nagy Pty Ltd* (1993) 113 ALR 225, 240-241, citing *Castlemaine v Carlton* above n 61, 490-493. See also the comments of Kirby J in *Roxboroguh v Rothmans* above n 32.

275. *Helicopter Sales Pty Ltd v Rotor-Work Pty Ltd* (1974) 132 CLR 1, Stephen J 12.

276. By virtue of the fifth requirement of the test in *BP Refinery*, see above pp 93-95.

277. *Castlemaine v Carlton* above n 61, Hope JA 492. In relation to good faith particularly, see *Pacific Brands Sport v Underworks* above n 16; *ACI v Berri* above n 15, para 175.

What constitutes inconsistency in each case is to be found in the intentions of the parties, as manifested by their written agreement, and the surrounding circumstances.[278] Of particular relevance will be the tenor of the language used in the express terms of the contract,[279] any provision made in the contract for the settlement of disputes,[280] and the extent to which the contracting parties' interests are reconcilable.[281]

3. Good faith and reasonableness: one term or two?

The Court of Appeal in *Burger King* noted that 'the Australian cases make no distinction of substance between the implied term of reasonableness and that of good faith'.[282] Whether or not the courts have maintained a substantive difference, they have arguably maintained a difference in form, often recognising separate, but parallel, terms of good faith and reasonableness.[283] The court in *Burger King*, in discussing the accumulated case law, used the plural '*terms* of good faith and reasonableness';[284] however, this distinction is not always maintained. In *Vodafone,* Giles JA observed:

> In the present case the implied terms were separated, but effectively an implied term that Vodafone would act in good faith and reasonably … was said to be implied in law.[285]

The uncertainty as to this point seems to stem from Priestley JA's comments in *Renard* that his conception of reasonableness had 'much in common' with notions

278. *Helicopter Sales v Rotor-Work* above n 275, Menzies J 6.
279. *Castlemaine v Carlton* above n 61, 491-492; *Devefi v Mateffy Pearl Nagy* above n 274, 240-241.
280. *Vodafone* above n 4, Giles JA paras 195-198, basing his conclusion that the implied term was excluded from the particular contract on the ground that the contract provided that the exercise of any discretion by Vodafone was specifically excluded from the matters referrable to arbitration. An application for special leave was filed, but settled and abandoned before the application was heard: *Mobile Innovations Ltd v Vodafone Pacific* [2004] HCA Trans 541.
281. *Vodafone* ibid, para 196. Giles JA noted that the parties' inconsistent interests under the contract created a fundamental tension that could only be resolved if one party had the 'whip hand'.
282. *Burger King* above n 4, para 169.
283. In *Alcatel* above n 4, 369, Sheller JA relied on the fact that the appellant had not demonstrated that the respondent's actions were unreasonable, although his Honour did not expressly conflate good faith and reasonableness. See also *Garry Rogers Motors v Subaru* above n 4, 43,014, where Finkelstein J explained that: 'provided the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied'. Proof of unreasonableness might be said to be a necessary, but not sufficient, condition for a breach of the implied term of good faith. Cf Carlin above n 6, 121, who argues that the above cases conflate good faith and reasonableness.
284. *Burger King* above n 4, para 159 (emphasis added). The use of the plural 'terms' reflects the distinction drawn by Rolfe J at first instance.
285. *Vodafone* above n 4, para 188. See also *Far Horizons v McDonald's* above n 4, Byrne J para 120.

of good faith.[286] Courts have since described the obligation variously as: 'good faith and fair dealing';[287] 'good faith and reasonabl[eness]';[288] or simply 'good faith'.[289]

The fusion of these two concepts has the potential significantly to enlarge the scope of the obligation, by virtue of the uncertainty which reasonableness invariably imports, and by the imposition of a more onerous standard, should the courts come to define reasonableness in the objective sense.[290] Any such enlargement of the concept of good faith would arguably signal a material departure from the familiar methods of supervising contractual performance discussed above. Both of these matters warrant consideration.

(i) The uncertainty of reasonableness

Reasonableness is an ambulatory concept,[291] though that has not prevented it from featuring in various statutory and common law rules.[292] However, uncertainty of meaning is particularly problematic when imported into a commercial contract between parties who may have differing views as to what is reasonable. Indeed, at first instance in *Burger King*, Rolfe J thought that 'reasonableness' could only be given meaning by 'a judicial assessment, which may not match that of the contracting parties as to what is reasonable, and which certainly may not be capable of clear expression',[293] suggesting that implication of an obligation to act reasonably ought to be made only with great caution.

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286. *Renard* above n 11, 263. The confusion was compounded by Sheller JA's conclusion in *Alcatel* above n 4, 369 that *Renard* was authority for an implied term of good faith.
287. *Hughes Aircraft v Airservices Australia* above n 4, Finn J 36; the term used in the joint judgment in *Royal Botanic Gardens v South Sydney CC* above n 19, 301, Kirby J 312. See also *Garry Rogers Motors v Subaru* above n 4, Finkelstein J 43,014.
288. *Burger King* above n 4, para 185. However, the court also referred to a breach of the obligation of good faith, without reference to reasonableness: ibid, para 343.
289. *Royal Botanic Gardens v South Sydney CC* above n 19, Callinan J 327.
290. Carter & Peden above n 5, 168.
291. Stroud's *Judicial Dictionary of Words and Phrases* 5th edn (London: Sweet & Maxwell, 1988) 2157 admonishes that: '[i]t would be unreasonable to expect an exact definition of the word reasonable'. Black's *Law Dictionary* 7th edn (St Paul: West Publishing, 1999) 1138 manages only synonyms: '[f]air, proper or moderate under the circumstances'. Butterworths' *Australian Legal Dictionary* (Sydney: Butterworths, 1998) 985 defines 'reasonableness' only in the *Wednesbury* unreasonableness sense.
292. Julius Stone wrote that abstract concepts such as 'reasonableness' 'provide by their vagueness and indeterminacy legal norms tolerant of conflicting solutions in broad penumbral areas, even while in the core area they admit into the law the more coherent insights of the society's widely shared convictions': J Stone *Legal System and Lawyers' Reasonings* (Sydney: Maitland, 1968) 21-22, cited by French J in *Bropho v HREOC* above n 9, 781.
293. *Hungry Jack's v Burger King* above n 184, Rolfe J para 423. See also Meagher JA in *Renard* above n 11, 275, who thought it all but impossible to 'ascribe a sensible meaning to' reasonableness.

(ii) Objective reasonableness (or fairness)

Perhaps more important than the inevitable uncertainty of meaning is the suggestion, commonly made, that reasonableness imposes a more onerous obligation than good faith alone.[294] Professor Stapleton, for instance, explains that a person may act in good faith, but unreasonably as judged against an objective standard,[295] perhaps because reasonableness may be regarded as requiring fairness, or justice, between contracting parties.[296] Although the *Burger King* court did not explain what it meant by 'reasonableness',[297] the court did refer to Sir Anthony Mason's suggestion that good faith incorporated 'compliance with standards of conduct which are reasonable having regard to the interests of the parties'.[298] The standard suggested by Sir Anthony suggests an evaluative, or objective, conception of reasonableness, determined by reference to the parties' respective interests.[299]

An obligation that contractual performance be objectively reasonable would represent a preference for fairness over certainty in excess of that currently evident in the obligation of co-operation. Such a step should be taken with great caution and precision, if at all. In regulating non-consensual relationships, such as in criminal and tort law, the reasonableness of conduct is rightly of central importance in determining rights and liabilities.[300] However, commercial parties themselves define their respective rights and obligations in their contracts. Moreover, it is by no means axiomatic that contracting parties, or the law,[301] intend that every contract be performed in accordance with objective reasonableness. Indeed, there may be sound commercial reasons why they are not.

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294. J Stapleton 'Good Faith in Private Law' (1999) 52 CLP 1, 8.
295. Ibid. Stapleton cites as an example statutory definitions of good faith such as the Sale of Goods Act 1979 (UK) s 61(1), which provides that 'a thing is deemed to be done in good faith within the meaning of this Act when it is in fact done honestly, whether it is done negligently or not'. In a different context, a requirement that an act be done 'reasonably' was held to have imported an objective assessment: *Hagan v Trustees of Toowoomba Sports Ground Trust* [2000] FCA 1615, Drummond J para 15.
296. *Renard* above n 11, Meagher JA 275, referring to the parties' contention that reasonableness involved 'the balancing of the interests' of both parties.
297. Carter & Peden above n 5, 168.
298. *Burger King* above n 4, para 171, referring to Mason above n 13.
299. In *Overlook v Foxtel* above n 4, 91,970, Barrett J thought that although not imposing a duty to prefer the other party's interests, good faith and reasonableness imposed a duty to 'recognise and 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'. If there is no duty to prefer the interests of the other party, it is difficult to see what is involved in 'having due regard to' those interests. Such a formulation, it is suggested, indicates the unwillingness of the courts to require power to be exercised reasonably, in the sense of fairly.
300. Gleeson above n 29, 428.
301. In *White and Carter (Councils) Ltd v McGregor* [1962] AC 413, 430, Lord Reid pointed out that 'it never has been the law that a person is only entitled to enforce his contractual rights in a reasonable way.… One reason why that is not the law is, no doubt, because it was thought that it would create too much uncertainty to require the court to decide whether it

So understood, an implied obligation of reasonableness would significantly expand the role of the courts in supervising contractual performance. Moreover, it would represent a shift in the balance between fairness and certainty apparent in the courts' use of implied terms of co-operation and equitable controls over the exercise of contractual rights, prior to the recent case law concerning terms of good faith.

Nevertheless, these concerns may be overstated, as it remains unclear whether the courts, in developing the implied obligations of good faith and reasonableness, have intended to impose a requirement of objective reasonableness. In *Burger King*, the court noted that although the appellant was bound to exercise its powers in good faith and reasonably:

> That does not mean that [the appellant] is not entitled to have regard only to its own legitimate interests in exercising its discretion. However, it must not do so for a purpose extraneous to the contract – for example, by withholding financial or operational approval…so as to thwart [the respondent's] rights under the contract.[302]

This passage suggests that reasonableness does not require a 'balancing of interests', or the subordination of self-interest,[303] but rather prevents the exercise of contractual power for extraneous or improper purposes. Such a restraint closely resembles that recognised by Stephen J in *Godfrey Constructions* as preventing reliance on a right to rescind a contract when it is exercised for an improper purpose,[304] and would, therefore, represent a refinement, rather than a redefinition, of contract law.[305]

(iii) Reasonableness in the *Wednesbury* sense

It has been suggested that if reasonableness is to have any independent content, it ought to be restricted to the administrative law concept of *Wednesbury*[306] reasonableness, which requires only that decisions not be so unreasonable that no

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is reasonable or equitable to allow a party to enforce his full rights under a contract'; see also Gleeson above n 29, 432: 'It is wrong to assume that, running throughout the law there is some general principle of fairness which will always yield an appropriate result if only the judge can manage to get close enough to the facts of the individual case.… A principle of law may be just, or wise, or convenient, even though it operates harshly in some cases.'

302. *Burger King Corp v Hungry Jack's* [2004] NSWCA 15, para 185.
303. *Overlook v Foxtel* above n 4, 91,970.
304. *Godfrey Constructions* above n 79, 549. See discussion above pp 73-77.
305. Anglo-Australian courts have long preferred to develop the law incrementally, by 'analogical reasoning', as opposed to open innovation: see eg O Dixon 'Concerning Judicial Method' in O Dixon *Jesting Pilate* (Melbourne: Law Book Co, 1965) 15; JD Heydon 'Judicial Activism and the Death of the Rule of Law' (2003) 23 ABR 110; cf M Kirby 'Judicial Activism? A Riposte to the Counter-Reformation' (2004) 24 ABR 219.
306. *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223, Lord Greene MR 234 (Sommervell & Singleton LJJ concurring).

reasonable person could arrive at them.[307] No Australian case has yet considered such a standard for contracting parties, and notwithstanding that the divide between public and private law is narrowing,[308] the fundamental differences between contractual and administrative relationships would necessitate great caution in incorporating analogous duties into contracts.[309]

It must be recognised though, that there is a line of English authority supporting the implication of a requirement of *Wednesbury* reasonableness into contracts,[310] and such a standard is not completely alien to private law in Australia.[311] Indeed, adoption of this lower standard may ameliorate some of the concerns discussed above, that the implied terms of good faith and reasonableness impose more onerous restraints on contractual performance than those imposed by more familiar principles.

V. CONCLUSION

The Anglo-Australian common law of contract has been built upon general principles that seek to uphold agreements and provide certainty, in combination with specific proscriptions of fraudulent, dishonest and unconscionable behaviour. Yet much commercial behaviour falls in the interstices of these principles. Perhaps in recognition of this, the courts have, for more than a century, implied a contractual obligation of co-operation, and imposed equitable restraints on the exercise of contractual powers. Although products of the classical era of contract theory, these are flexible principles, which allow the courts to go beyond the express words of a contract in order to uphold the agreement, while at the same time ameliorating the occasionally harsh effects of freedom of contract.

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307. Carter & Peden above n 5, 168. The authors see this as inherent in the notion of honesty, and therefore inherent in all aspects of contract law. However, even completely irrational conduct might be honest, though whether it ought to be permitted by the law is a separate question.
308. Eg J Beatson 'Public Law Influences in Contract Law' in Beatson & Friedman *Good Faith and Fault in Contract Law* above n 22, 263; also P Finn 'Controlling the Exercise of Power' (1996) 7 PLR 86; D Oliver 'Common Values in Public and Private Law and the Public/Private Divide' [1997] PL 630; D Oliver 'The Human Rights Act and the Public Law/Private Law Divides' (2000) 4 EHRLR 343, 343-345 where the author observes that many of the principles of public law have been 'borrowed' from private law and equity, and that those public law principles are now being 'borrowed back' in their modern form to rationalise diverse areas of private law.
309. For the reference to the differing nature of contractual and administrative power, see above pp 97-100.
310. *The Product Star (No 2)* [1993] 1 Lloyd's Law Rep 397, Leggatt LJ 404; *Gan Insurance v Tai Ping Insurance* above n 224, Mance LJ para 67; *Paragon Finance v Staunton* above n 223, Dyson LJ 702, as to which a petition for leave to appeal to the House of Lords was dismissed: *Paragon Finance Plc v Nash* [2002] 1 WLR 2263.
311. In respect of a healthcare professional's liability in negligence, see eg the recently introduced s 5PB(4) of the Civil Liability Act 2002 (WA).

Examination of the decisions in *Renard* and *Burger King* reveals that the results wrought by the application of good faith or reasonableness could have been achieved by application of the implied obligation of co-operation, complemented by traditional equitable restraints on the exercise of contractual powers. A brief survey of the United States case law suggests that in that jurisdiction too, the role of good faith does not materially vary from the established role of co-operation in Australian law.

It has been recognised that although the content of the obligation of good faith may mirror the obligation of co-operation, recognition of an obligation of good faith may still significantly impact upon commercial activity, depending upon the source of the obligation, and whether it can be excluded. Significantly, these are issues yet to be resolved in relation to the obligation of co-operation. Nevertheless, it has been suggested that good faith and co-operation are properly terms to be implied by law, and that arguments good faith should be a mandatory term of every contract are without a sound doctrinal basis. It is appropriate that good faith be treated as any other implied term, capable either of exclusion by express words or as a result of inconsistency with the express terms of the contract.

The courts' invocation of reasonableness, in addition to, or conflated with, good faith creates the greatest potential for the new implied obligation to exceed the old. For the courts to assess commercial behaviour by reference to an objective standard of reasonableness would mark a significant departure from the principle of freedom of contract woven throughout the common law. Yet it remains unclear whether such a departure was intended by the recent case-law concerning good faith in the performance of contracts. There is reason to think that the courts, by their use of reasonableness, are more concerned with proscribing the exercise of power for extraneous purposes than with adjudicating the fairness or otherwise of commercial conduct.

To date, the courts' application of the implied obligation of good faith has not signalled any material departure from the familiar principles with which the courts in this country have controlled contractual performance. Gummow J's observation that the obligations of co-operation and good faith had shared origins might well be matched by the conclusion that, many years later, they have arrived at the same place. Indeed, it might be concluded that implied obligations of good faith and reasonableness amount to little more than old wine in new bottles.