

An Implied Term of Good Faith?

Glenn Fredericks, State Chambers

A. Introduction

The concept of ‘good faith’ has been recognised by a number of Australian courts as being “an implication or feature of Australian contract law attending the performance of the bargain and its construction and implied content”¹. It has also been recognised in a number of other jurisdictions².

However, “the question whether a standard of good faith should be applied generally to contracts has not been resolved in Australia”³. In particular, it has not been resolved by the High Court.⁴ Indeed, it can be said that the indications from the High Court have not been in favour of the implication of such a term, with Kirby J stating that:

such an implied term appears to conflict with fundamental notions of *caveat emptor* that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include⁵.

Further, and despite the authorities discussed below, as noted by North J in *Yousif v Commonwealth Bank of Australia (No 2)*:

An authority cited in support of the implication of such a term was the judgment of Rothman J in *Russell v Trustees of the Roman Catholic Church, Archdiocese of Sydney (2007) 69 NSWLR 198; 167 IR 121*. However, there is a preponderance of authority against the implication of such a term: *Aldersea v Public Transport Corporation (2001)*

¹ *Paciocco v Australia and New Zealand Banking Group Limited* [2015] FCAFC 50; 236 FCR 199 at [287] (Allsop CJ) (*Paciocco*).

² *Ibid* at [291]; *Hughes Aircraft Systems International v Airservices Australia* [1997] FCA 558; (1997) 76 FCR 151 at 188-198 (Finn J).

³ *Commonwealth Bank of Australia v Barker* [2014] HCA 32; 253 CLR 169 at [107] (Kiefel J) (*Barker*).

⁴ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5; (2002) 240 CLR 45 at [40] (Gleeson CJ, Gaudron, McHugh, Gummow & Hayne JJ), at [155] (Callinan J).

⁵ *Ibid* at [87], see also at [155] (Callinan J).

3 VR 499; *Walker v Citigroup Global Markets Pty Ltd* (2005) 226 ALR 114; *McDonald v Parnell Laboratories (Aust) Pty Ltd* (2007) 168 IR 375.⁶

This paper will firstly consider how a term of good faith might be defined (that is, what rights or obligations are encompassed by the term) by reference to Australian and foreign law. It will then look at instances where the term is imposed by statute before considering what future there is for the term post-*Barker*.

B. What is encompassed by the good faith term?

Consistent with the uncertainty as to whether the implication of a good faith term is part of Australian law, there is no authoritative Australian statement as to the content of the term⁷.

Sir Anthony Mason suggested that the content is:

“(1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);
 (2) compliance with honest standards of conduct;
 (3) compliance with standards of conduct which are reasonable having regard to the interests of the parties.”⁸

However, this is not necessarily the definition which has been adopted by the courts.

New South Wales

In New South Wales, the starting point to considering the meaning of the term, is the decision of the NSW Court of Appeal in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*⁹. In his judgment, Priestly JA engaged in a lengthy consideration of the meaning and antecedents of good faith and considered its requirements in terms of reasonableness¹⁰ and as excluding conduct not in good faith¹¹.

His Honour also stated:

⁶ [2009] FCA 656 at [106].

⁷ J Carter *Good Faith in Contract: Why Australian Law Is Incoherent*, Legal Studies Research Paper No. 14/38 University of Sydney April 2004.

⁸ A.F. Mason, *Contract, Good Faith and Equitable Standards in Fair Dealing* (2000) 116 *The Law Quarterly Review* 66, 6, cited in *Alcatel Australia Ltd v Scarcella* [1998] NSWSC 483; 44 NSWLR 349 (*Alcatel*) at 367 per Sheller JA.

⁹ (1992) 26 NSWLR 234 (*Renard*).

¹⁰ *Ibid* at 263.

¹¹ *Ibid* at 266.

people generally... have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all contracts of a duty upon the parties of good faith and fair dealing in its performance¹².

and

Similarly, there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability. Although they may not be always co-extensive in their connotations, partly as a result of the varying senses in which each expression is used in different contexts, there can be no doubt that in many of their uses there is a great deal of overlap in their content, particularly in the kind of situation being discussed in the present case.¹³

In *Alcatel*, Sheller JA considered a term of reasonableness and good faith. Sheller JA said that there could be an obligation of good faith implied into commercial contracts and stated that¹⁴:

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. Thus, a vendor may not be allowed to exercise a contractual power where it would be unconscionable in the circumstances to do so.

His Honour concluded:

The decisions in *Renard Constructions* and *Hughes Bros* mean that in New South Wales a duty of good faith, both in performing obligations and exercising rights, may by implication be imposed upon parties as part of a contract. There is no reason why such a duty should not be implied as part of this lease.¹⁵

In *Burger King Corporation v Hungry Jack's Pty Limited*¹⁶, the term was described as a conjunction of “good faith and reasonableness”¹⁷.

¹² *Ibid* at 268.

¹³ *Ibid* at 265.

¹⁴ *Ibid* at 368.

¹⁵ At 369.

¹⁶ [2001] NSWCA 187; 69 NSWLR 558 (*Burger King*).

¹⁷ *Ibid* at [181].

It should be noted that there has been some resistance to recognising the existence of an implied term of good faith in all contracts. In *CGU Workers Compensation (NSW) Ltd v Garcia*¹⁸, Mason P stated that *Renard* and *Burger King* “do not establish that such an implied term is to be inserted into every contract or even into every aspect of a particular contract”¹⁹.

More recently in the Federal Court, Allsop CJ, summarised the obligation imposed by the term²⁰ as being:

an obligation to act honestly and with a fidelity to the bargain; an obligation not to act dishonestly and not to act to undermine the bargain entered or the substance of the contractual benefit bargained for; and an obligation to act reasonably and with fair dealing having regard to the interests of the parties (which will, inevitably, at times conflict) and to the provisions, aims and purposes of the contract, objectively ascertained.

His Honour (when President of the NSW Court of Appeal) had previously stated that:

What the phrase “good faith” signifies in any particular context and contract will depend on that context and that contract. A number of things, however, can be said as to the place of good faith in the operation of the common law in Australia. The phrase does not, by its terms, necessarily import, or presumptively introduce, notions of fiduciary obligation familiar in equity or the law of trusts. Nor does it necessarily import any notion or requirement to act in the interests of the other party to the contract²¹.

In *Barker*, Keifel J stated that “fairness in dealings between contracting parties may be understood as an aspect of the duty of good faith... and is wider than that of honesty”²².

In considering what a good faith term might encompass, it is also important to have regard to the potential boundaries set by *Barker*. In *Barker*, the High Court found that there was not an implied term of trust and confidence implied by law into contracts of employment. This term was:

¹⁸ [2007] NSWCA 193, 69 NSWLR 680 (*CGU*).

¹⁹ *Ibid* at [131], Hodgson (at [159]) and Santow JJA (at [168]) agreeing. See also *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177, 74 NSWLR 618 at [69] (Allsop P) (*United Group*).

²⁰ *Paciocco* at [288].

²¹ *United Group* at [70].

²² *Barker* at [104].

that neither party will, without reasonable cause, conduct itself in a manner likely to destroy or seriously damage the relationship of trust and confidence between them.²³

Before the decision in *Barker*, it was often the case that good faith, and trust and confidence terms, were pleaded as the one term²⁴. Further, one can see that there will be some overlap between the two terms. However, it must be that the scope of the trust and confidence term sets some limit on what a good faith term might encompass. It is unlikely that the High Court would approve a good faith term which was simply a re-badging of the trust and confidence term.

The good faith term may also need to be distinguished from the duty of parties to co-operate. This is not a general obligation to co-operate or to act co-operatively. Rather, it "is anchored upon the need for one party to take a positive step without which the other party is unable to enjoy a right or benefit conferred upon it by the contract."²⁵

Having regard to these boundaries, we are possibly left with a definition which reflects the Canadian or US positions described below.

Other jurisdictions

There have been some pronouncements by English courts that a term of good faith is generally implied into contracts. However, the Court of Appeal has stated "that English law does not recognise any general duty of good faith in matters of contract"²⁶.

The implication of a term of good faith has been recognised in Canada and the United States. The Supreme Court of Canada recognised that Anglo-Canadian law had:

resisted acknowledging any generalized and independent doctrine of good faith performance of contracts. The result is an "unsettled and incoherent body of law" that has developed "piecemeal" and which is "difficult to analyze."²⁷

Accordingly, the Court determined that:

it is time to take two incremental steps in order to make the common law less unsettled and piecemeal, more coherent and more just. The first step is to acknowledge that good faith contractual performance is a general organizing principle of the common law of

²³ *Ibid* at [15] (French CJ, Bell & Keane JJ).

²⁴ J. Riley "Siblings But Not Twins" (2012) 36 *MULR* 521.

²⁵ *Barker* at [89] per Kiefel J quoting with approval the majority in *Commonwealth Bank of Australia v Barker* (2013) 214 FCR 450; see also E. Peden, "Good Faith in the Performance of Contracts", *Lexis Nexis Butterworths* 2003 at [6.6] to [6.9].

²⁶ *MSC Mediterranean Shipping Company S.A v Cottonex Anstalt S.A.* [2016] EWCA Civ 789 at [45] (Moore-Bick LJ).

²⁷ *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 S.C.R. 494 at [32].

contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance. The second is to recognize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations.²⁸

In the United States, *The Uniform Commercial Code* (2012)²⁹ states at §1-304:

Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

Good faith itself is defined in §1-201 as “honesty in fact and the observance of reasonable commercial standards of fair dealing”.

Further, §205 of the *Restatement (Second) Contracts* (1979)

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.

C. The Legislative Framework

The legislative framework is important for two reasons. First, in considering where good faith obligations may be found in contracts, it is important to consider where statute might impose (directly or indirectly) an obligation on parties to act towards each or utilise their respective rights under the contract in good faith.

Secondly, in considering the issue of a possible implied term of trust & confidence, the High Court paid close attention to the statutory framework in place which dealt with employment relationships, referring to the "symbiotic relationship" of legislation and the common law³⁰. Accordingly, it may be that the more Australian parliaments have addressed the issue of where good faith obligations should be imposed, the less need there is for the common law to recognise such a term.

In this respect, the following are instances of where good faith obligations are imposed on parties to a contract:

²⁸ *Ibid* at [33].

²⁹ S.J. Burton, “History and Theory of Good Faith Performance in the United States” (1995) *U Iowa Legal Studies Research Paper* No. 2017-08: “The now-considerable case law has taken on a distinctly free market orientation, regularly construing good faith to protect and serve the parties' justified expectations arising from their promises”.

³⁰ *Barker* at [17] (French CJ, Bell and Keane JJ).

Franchising Code of Conduct

Clause 6(1) of the *Franchising Code of Conduct* provides that “Each party to a franchise agreement must act towards another party with good faith, within the meaning of the unwritten law from time to time” (emphasis added). Further, while referring to the unwritten law, subclause (3) provides that, in considering whether a party has contravened subclause (1), “the court may have regard to:

- (a) whether the party acted honestly and not arbitrarily; and
- (b) whether the party cooperated to achieve the purposes of the agreement”

ASIC Act

The *Australian Securities and Investment Commission Act 2001* (Cth), imposes what might be regarded as an indirect obligation of parties to a contract to act in good faith. Section 12CB of that Act imposes a prohibition on a person engaging in conduct which is unconscionable in connection with the supply of acquisition of financial services. Section 12CC then provides that Court may have regard to the extent to which “the supplier and the service recipient acted in good faith” in considering whether there has been a breach of section 12CB.

ACL

The *Australian Consumer Law* operates in a similar manner to the *ASIC Act*, with section 22 providing that a court may have regard to “the extent to which the supplier and the customer acted in good faith” in determining whether the obligation under section 21, to not engage in unconscionable conduct with respect to the supply of goods and services, has been breached.

Insurance Contracts Act:

The *Insurance Contracts Act 1984* (Cth) does not deal with the concept of good faith, but with the concept of utmost good faith (*uberrima fides*).³¹ Section 13(1) provides that “a contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith”.

³¹ “The duty of utmost good faith has been said to:

- impose principles of fairness and honesty,
- compel full and frank disclosure;
- require notice of important obligations;
- necessitate avoidance of conflicts of interest; and
- oblige a timely response to a claim for indemnity.”

Matton Developments Pty Ltd v CGU Insurance Limited (No 2) [2015] QSC 72 at [246] (footnotes omitted).

The Employment Relationship

There is not a statutory obligation on parties to deal with each other in good faith. This can be contrasted with, for example, the situation in New Zealand where the *Employment Relations Act 2000* (NZ) provides that the parties to an employment relationship:

- (a) must deal with each other in good faith; and
- (b) without limiting paragraph (a), must not, whether directly or indirectly, do anything—
 - (i) to mislead or deceive each other; or
 - (ii) that is likely to mislead or deceive each other.³²

D. The good faith term post-*Barker*

The final issue addressed by this paper is what the future might be for the general implication of a good faith term into contracts. As noted above, despite some assertions that a term of good faith is part of the law of Australia, it is doubtful that this is so. Further, the approach of the High Court in considering an implied term of trust and confidence may suggest that the Court would not be likely to find that the good faith term is generally implied.

In *Barker*, the plurality made a number of statements as to how the implication of terms should be considered, and said that the:

common law in Australia must evolve within the limits of judicial power and not trespass into the province of legislative action.³³

[Further, a] judicial announcement of an obligation of mutual trust and confidence, to be applied as an incident of employment contracts and applicable to employers and employees alike, involves the assumption by courts of a regulatory function defined by reference to a broadly framed normative standard.³⁴

The plurality also stated that:

implications in law must be kept within the limits of the judicial function. They are a species of judicial law-making and are not to be made lightly. It is a necessary condition that they are justified functionally by reference to the effective performance of the class

³² Section 4.

³³ At [19] (French CJ, Bell J and Keane J).

³⁴ *Ibid* at [20].

of contract to which they apply, or of contracts generally in cases of universal implications, such as the duty to cooperate. Implications which might be thought reasonable are not, on that account only, necessary. The same constraints apply whether or not such implications are characterised as rules of construction.³⁵

However, the plurality did recognise that “[b]roadly framed normative standards are familiar to courts required to apply, in common law or statutory settings, criteria such as “reasonableness”, “good faith” and “unconscionability””.³⁶

It can be said that, since *Barker*, the courts have continued to show the same reluctance to recognise that the common law implies such a term, particularly in the context of contracts of employment:

- *State of New South Wales v Shaw*³⁷: The NSW Court of Appeal found, had it been necessary to decide the issue, that it was not necessary to imply a term of good faith into the contract in question, in light of the statutory and industrial regime which regulated the employment contracts in question.
- *Gramotnev v Queensland University of Technology*³⁸: In this case, Jackson J conducted a review of the authorities³⁹ before finding that there was no term in the contract in question as pleaded.⁴⁰
- *Regulski v State of Victoria*⁴¹: The Court recognised that the issue of the implication of a good faith term had been left open by *Barker*. Jessup J stated that, in the context of employment contracts, “I do not believe that the existence of a term expressed as the applicant has done in this case – that the parties ‘would act in good faith towards each other’ – has ever been suggested”⁴². However, Jessup J decided that the term did not “come into play” based on the facts of that case.
- *Whelan v Cigarette & Gift Warehouse Pty Ltd*⁴³. The Court stated that it did “not consider that Australian law implies such duty into contracts of employment”⁴⁴ on

³⁵ *Ibid* at [29].

³⁶ *Ibid* at [20].

³⁷ [2015] NSWCA 97.

³⁸ [2015] QCA 127; 251 IR 448.

³⁹ At [157]-[171].

⁴⁰ At [172].

⁴¹ [2015] FCA 206 (Jessup J); see also *Four yearly review of modern awards* [2016] FWCFB 6836 (22 September 2016) at [66].

⁴² *Ibid* at [219].

⁴³ [2017] FCA 1534 (Collier J).

⁴⁴ *Ibid* at [217].

the basis “that necessity does not demand its implication into contracts of employment, but also because of a lack of certainty about the content of such a duty in the employment context.”⁴⁵

Finally, regardless of whether or not a term of good faith is implied into contracts generally, a court may still find that terms should, as a matter of construction, be interpreted consistently with notions of good faith and reasonableness⁴⁶. An example is whether a discretion, reserved in the contract, must be interpreted as being required to be exercised in good faith (or reasonably).

In *Renard*, the contract under consideration (a construction contract) contained a clause which permitted the principal to take over or cancel the contract if the contractor failed to show cause, “to the satisfaction of the Principal”, why that power should not be exercised. The majority of the Court of Appeal (Priestley & Handley JJA) held that the powers conferred by the clause had to be read with the constraint of reasonable use (or good faith) as otherwise it would be “quite inconsistent with all the main contractual promises by each party to the contract to the other”.⁴⁷

More recent examples include:

- *McKeith v Royal Bank of Scotland Group PLC; Royal Bank of Scotland Group PLC v James*⁴⁸: the appellants accepted that a discretion regarding whether or not to provide a discretionary bonus had to be exercised in good faith.
- *Bartlett v Australia & New Zealand Banking Group Ltd*⁴⁹: the contract of employment has a provision allowing the employer to terminate where serious misconduct occurred in the employer’s opinion ‘for any reason’. The Court held that the Bank was obliged in forming its opinion to act reasonably, at least in the *Wednesbury* sense and at least so far as its process, as distinct from the result, was concerned. The Court held that the Bank did not do this as a result of deficiencies in its investigation of the alleged misconduct.⁵⁰

⁴⁵ *Ibid* [224].

⁴⁶ Noting the High Court’s statement that issues regarding implication of the term also apply to construction (see n35 above).

⁴⁷ *Renard* at 258 (Priestley JA).

⁴⁸ [2016] NSWCA 36.

⁴⁹ [2016] NSWCA 30.

⁵⁰ *Ibid* at [49], [51] (Macfarlan JA).

- *UGL Rail Services Pty Limited v Janik*⁵¹: An options clause contained an implied promise that the consideration of a recommendation made under it would be made honestly and that it would not be made arbitrarily or capriciously. The Court was also prepared to imply a term that the consideration would be done consistently with the proper scope and content of the relevant agreement⁵².

E. Conclusion

The position in NSW, in light of *Renard*, *Alcatel* and *Burger King*, appears to support the implication of a term of good faith⁵³. However, it is clear that the existence and meaning of an implied term of good faith in Australian contract law remains uncertain, which places those seeking to interpret and enforce contractual terms in a difficult position:

At the moment it seems we have to put up with the worst of both worlds: cases adopting an overly literal approach to construction but at the same time, but not coherently, conjuring up implied terms with the object of contradicting the literal construction of the contract.⁵⁴

Glenn Fredericks

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⁵¹ [2014] NSWCA 436.

⁵² *Ibid* at [189] (Sackville AJA).

⁵³ See also *United Group* at [60]-[61] (Allsop P), but see contra *CGU* (*op cit* n18).

⁵⁴ Carter, *op cit* n7, at 49.