Good Faith: When, What and How?

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Introduction

The current position in Australia

- When does good faith arise?
- What does it mean? Good faith at different stages of the contractual process:
  - Pre-Contractual Negotiations
  - Performance of Contract
  - Exercise of rights including termination
  - Dispute resolution
- Definition and content of good faith
- How do you contract out of good faith?
When does good faith arise?

Express term

- Eg “The Principal shall ensure that at all times there is a Superintendent, and that the Superintendent fulfils all aspects of the role and functions reasonably and in good faith”

Implied term

- By fact or by law: weight of authority supports implication by law (but not without limits)

By Statute
Implied Terms

Implication by fact

- Business efficacy
- Presumed intention of the parties – necessary to make the contract workable
- *BP Refinery v Shire of Hastings*: reasonable and equitable, necessary to give efficacy, so obvious it “goes without saying”, capable of clear expression, cannot contradict express term

Implication by law

- Types of contract where relationship of established kind
- Derived as a matter of law from relationship
- Can be excluded by express words
### Implied term of good faith in different jurisdictions

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Implied by law</th>
<th>Key cases</th>
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<tbody>
<tr>
<td>New South Wales</td>
<td>Yes</td>
<td>Renard; Burger King; Alcatel; Overlook; Vodafone; CGU; Insight Oceania; Starlink; NSW Rifle Association</td>
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<tr>
<td>Victoria</td>
<td>No</td>
<td>Esso; Healthscope; Dura; Arhanghelschi</td>
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<tr>
<td>South Australia</td>
<td>Yes</td>
<td>Alstom</td>
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<tr>
<td>Queensland</td>
<td>Undecided</td>
<td>Kendall</td>
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<tr>
<td>Western Australia</td>
<td>Undecided</td>
<td>Trans Petroleum; Hampton</td>
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<tr>
<td>Tasmania</td>
<td>No</td>
<td>Tote Tasmania; Driveforce</td>
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<tr>
<td>Northern Territory</td>
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Implied Terms

- Good faith terms have been implied into a number of types of contracts:
  - Leases: *Alcatel; NSW Rifle Association* (licence analogous to a lease)
  - Franchise agreements: *Far Horizons, Burger King*
  - Motor vehicle dealership agreements: *Garry Rogers*
  - Contract between head contractor and subcontractor: *Alstom*
  - All commercial contracts? Yes in South Australia (*Alstom*), and possibly in New South Wales (*Overlook*)
Implied Terms

The “no” case CGU:

- Good faith is not to be implied into every contract or into every aspect of a particular contract.
- Central criterion is “necessity” and must be tested against statutory policy.
- Contrary to express terms and statutory framework.

The “no” case in Esso and Dura:

- “If a contractual right or power which is intended to advance only the interests of the party on whom it is conferred, is fettered by an implied obligation of good faith, resort to the duty may become an obstacle to the promotion of that party’s legitimate interests.” (Buchanan JA in Esso).
- The relationship between the parties was not unbalanced – Dura was not at a substantial disadvantage or particularly vulnerable (Dura per Dixon J).
Implied Terms

The “yes” case in *Alstom* and *Overlook*:

- Good faith is a term to be implied in every commercial contract.
- Supported by case law in New South Wales (*Overlook*)?
- Supported by the laws of contract in the US, Europe, Canada, New Zealand, China, Japan and other parts of the world (*Alstom*).
- But even if not implied universally, “this contract is one example of the type of contract where it must be implied” (*Alstom*).
Implied Terms: Contracts with Government – A Higher Standard?

- **NSW Rifle Association:** “The fact that the contract is with the government does not displace an obligation of good faith and reasonableness. *If anything, that is a factor in favour of the implication of the term*”

- **Hughes Aircraft Systems:** Contracting party an organ of the government = reason for implying a term requiring fair dealing

- **Skywest:** “It is in the public interest that when a government contracts with an ordinary person, it deals fairly with that person, and is seen to do so”
The High Court

• No consideration of the issue of good faith by the High Court, although some obiter comments.
  ▪ “Whilst the issues respecting the existence and scope of a “good faith” doctrine are important, this is an inappropriate occasion to consider them” (*Royal Botanic Gardens* per Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ).
  ▪ The implied term of good faith “appears to conflict with fundamental notions” (*Royal Botanic Gardens* per Kirby J (in dissent)).
  ▪ An argument based on an implied term of good faith appears to be “far-reaching” (*Royal Botanic Gardens* per Callinan J).

• Key decisions yet to be made
Statute

- S21 of the Australian Consumer Law (Schedule 2 to the *Competition and Consumer Act 2010* (Cth)) prohibits unconscionable conduct (old s51AC of the Trade Practices Act).
- S22 of the Australian Consumer Law: Matters the court may have regard to for the purposes of s21.
  - Court may have regard to whether parties acted in good faith and to bargaining strength, undue influence or pressure, terms not reasonable, failure to disclose.
- “Good faith” under s22 may be used interchangeably with “moral fault” (*Violet Home Loans v Schmidt*)
Good faith at different stages of contract

Pre-Contractual Negotiations

- No duty or obligation to negotiate in good faith
- Conduct already covered by equity and misleading and deceptive conduct and unconscionability laws e.g. Australian Consumer Law, ASIC Act
- Can agree to negotiate in good faith if terms are not too vague to be enforceable: Coal Cliff Collieries v Sijehama
- The Courts will hold back in giving effect to arrangements that the parties have not concluded
Good faith at different stages of contract

Performance of contract or the exercise of rights?

- Exercise of power to terminate (most common):
  - *Renard*: principal’s power to cancel the contract must be exercised reasonably (but not difficult for principal to show it had been reasonable)
  - *NSW Rifle Association*: the Commonwealth is required to act reasonably and in good faith in exercising its power to terminate for the licensee’s default
  - *Dura*: even where good faith is not implied, a principal needs to make a decision (in serving its show cause notices and in assessing whether Dura had shown cause) honestly
  - *Arhanghelschi*: The trust deed shows clear intent that the majority of unitholders (if they did not wish to continue working together) may act legitimately to require the cancellation of a unitholder’s units in their own self-interest and without disclosing any reason for doing so
  - Can be excluded by a broad termination clause
Good faith at different stages of contract

Performance of contract or the exercise of rights?

- Performing obligations and exercising rights:
  - Implied duty of good faith “both in performing obligations and in exercising rights” (Alcatel)
  - Express contractual provision to act with good faith in the performance of duties, in the exercise of powers and in the parties’ dealings with one another (Macquarie)
Good faith at different stages of contract

Performance of contract or the exercise of rights?

• General implication though relevantly in the exercise of a discretion: 
  *Burger King*

• Exercise of powers: *Far Horizons*

• In performance of contract and exercise of powers (eg terminate): *Garry Rogers; Alstom*

• Joint participation in a contractual process or mechanism: *Insight Oceania*
Good faith at different stages of contract

Disputes

- Only where express
- Sufficiently certain to be enforceable: *Aiton v Transfield; United Group Rail Services v Rail Corporation NSW*
- Not in breach of obligation to settle disputes in good faith to:
  - reject the other party’s proposed process for submissions and exchange of information; and
  - request the involvement of the engineer’s insurer in alternative dispute resolution.

*(Parsons Brinckerhoff v Thiess Pty Ltd)*
Good Faith – What Does it Mean?

The spectrum

Fiduciary duty (i.e. act in another’s best interests)

Pure commercial self-interest (i.e. without regard to another party’s interests at all)
Content and meaning

No settled definition in Australia

- Sir Anthony Mason: (1) an obligation on the parties to cooperate in achieving the contractual objects, (2) compliance with honest standards of conduct and (3) compliance with standards of conduct which are reasonable having regard to the interest of the parties.

Two Limb Test:

(1) performance obligations
(2) negotiation obligations

- To be assessed and interpreted in light of the particular agreement, its terms and circumstances: Macquarie
Limb 1: The Performance Obligations

1. Obligation to act honestly and with fidelity to the bargain
2. Obligation to act reasonably and with fair dealings
3. Not to act in bad faith (e.g. acting with ulterior motive)

Not to act in a way which is at odds with the contract - do not have to subordinate parties’ own interests
Limb 2: The Negotiation Obligations

• Must give serious and genuine consideration to the other party’s position.
  ▪ Parties to actively engage in the process of negotiations (e.g. keep an open mind).
  ▪ Serious and genuine consideration to the counterparty’s proposals.
  ▪ Willingness to give consideration to one’s own options for the resolution of a dispute.

• Will not be in breach by a mere failure to agree or putting forward an “unreasonable position”
Content and Meaning: The Government’s Model Litigant Guidelines

• *Legal Services Directions 2005* (Cth), Schedule, Appendix B:
  - The Commonwealth and its agencies are to behave as model litigants in the conduct of litigation
  - This requires the Commonwealth and its agencies to “act *honestly* and *fairly* in handling claims and litigation brought by or against the Commonwealth or an agency”
  - When participating in ADR the Commonwealth and its agencies are to ensure their representatives participate fully and effectively.

• Victorian Model Litigant Guidelines – contain substantially similar obligations
Example: Hypothetical

- Agreement for Lease: We Build Buses Pty Ltd (WBB) is to build school buses to lease them to A-Grade Primary School (APS) – run by the Victorian Department of Education.

- APS’s design brief differs in cost to other similar school buses. Under the Agreement, APS is to pay WBB the cost difference (works costs).

- Good faith clause: “WBB and APS acting reasonably and in good faith must attempt to resolve any differences they may have in relation to WBB’s determination of the works costs and the amount that APS is to contribute towards the works costs (if any) and the manner in which this contribution is to be made”.

- Termination clause: “If WBB and APS fail to agree on the works costs or the amount that APS is to contribute towards the works costs, and the terms and conditions on which this contribution is to be made, WBB and APS may terminate the Agreement by giving notice in writing to the other.”
Example: Hypothetical (continued)

- For a month, WBB and APS attend meetings, exchange correspondence and otherwise communicate the differences in the parties’ positions in relation to the calculation of the works costs and APS’s contribution to these costs.
- WBB’s final position is that APS’s contribution to works costs should be $3 million. APS’s final position on this is $1 million.
- APS fails to disclose to WBB a consultant’s report APS used to determine the works costs. If this had been disclosed, the parties’ positions would have been $1.6 million apart (instead of $2 million).
- APS terminates the Agreement because the parties fail to agree.
- Is APS in breach of the obligation to attempt to resolve the differences with WBB in good faith? Do any particular obligations apply to APS as a government department?
Example: Hypothetical (continued)

- Performance and enforcement obligations
  - APS did not act dishonestly or seek to prevent the performance of the Agreement or terminated the Agreement to further an ulterior purpose.
  - APS was committed to negotiating with WBB to progress the manufacturing of the buses.
  - APS only terminated because WBB and APS could not agree on the works costs.
  - The gap between APS and WBB was too big ($2 million).

- Negotiation obligations
  - APS failed to disclose the consultant report.
  - Did APS communicate the substance of the report to WBB?
Exclusion of good faith

Can you exclude it from a contract?

- Yes
- But whether this is desirable or achievable (to a degree) depends on the party’s relative bargaining power.
Exclusion of good faith

How to exclude good faith

• Best approach: exclude good faith expressly and very clearly (ie include a provision in the contract that excludes any implied terms)
• Entire agreement clause not sufficient (*BAE Systems*; *Far Horizons*)
• Sole discretion (effective in *Vodafone*)
• Broad discretion to terminate unlikely to be restricted by an implied term of good faith (*Sundararajah*; *Starlink*; *Trans Petroleum*; *Solution 1*; *Arhanghelschi*)
• Termination for convenience clause may qualify the obligation of good faith (*BAE Systems*)
• No other/additional obligations (to rebut it being implicit)
• Cannot exclude statute
Example: exclusion clause 1

- “This Contract, as varied from time to time, is an exhaustive statement of the parties’ contractual obligations and supersedes and replaces all statements, representations or possible undertakings that were the subject of discussion or correspondence between the parties, or that occurred during the tender process, prior to signing this Contract. To the extent permitted by law, any representation, statement, advice or information provided by the Prime Contractor, whether negligent or otherwise, is not actionable by the Subcontractor unless it is included as a term of this Contract”.

- Is the implied duty of good faith excluded?
Example: exclusion clause 2

• “Each Contracting Entity excludes all terms (including conditions and warranties) that would otherwise be implied into this Agreement”.

• Is the implied duty of good faith excluded?
Example: exclusion clause 3

- “[Party A] will have the sole discretion to determine, from time to time, the target level in respect of the number of connections of New Subscribers.”
- The Agreement requires [Party B] to meet the target level.
- Must [Party A] act in good faith in exercising its power to determine the target level?
Conclusion
Allens is an independent partnership operating in alliance with Linklaters LLP.