

GOOD FAITH AND REASONABLENESS IN THE PERFORMANCE OF CONTRACTS

Need to know

- Most jurisdictions have shown at least *some* support for the proposition that a duty of good faith and fair dealing is part of the law of contractual performance in Australia. However, the High Court is yet to resolve the issue, including the method of incorporation and the meaning of such a duty.
- It seems accepted that “good faith” imparts at least an obligation to act honestly and with a fidelity to the bargain. However, it does not require a contracting party to prefer the interests of the other contracting party, or to subordinate its self-interest.
- An implied or imposed duty requiring “good faith and reasonableness” can be excluded by express contractual provision or because it is inconsistent with the terms of the contract. However, it is not possible to exclude requirements of basic honesty.
- Parties should conduct themselves as though the duty applies, or expressly exclude such a duty, until the High Court ultimately determines the position.

Good faith in the performance of contractual obligations

1 The role of good faith and reasonableness in the performance of contracts

The role of good faith and reasonableness in the performance of contracts is not currently settled in Australia. The High Court has acknowledged the importance of this issue, and the uncertainty it has caused, but has not yet been presented with an appropriate case in which to consider the matter and resolve it.¹

While recognising this², most jurisdictions have shown at least *some* support for the proposition that an obligation or duty of good faith and fair dealing is part of the law of contractual performance in Australia in some way.

Different approaches include:

- good faith, in some degree or to some extent, is part of the law of performance of *all* contracts;³
- a duty of good faith and reasonableness will be incorporated into a contract where the requirements for implication of a term in fact are met (including that the term is *necessary* for business efficacy);⁴ and
- some courts draw analogies between the exercise of administrative law powers and the exercise of contractual rights and discretions, and import fetters preventing the exercise of the right/discretion for a purpose outside the contract, “capriciously”, “arbitrarily” or “unreasonably”.⁵

2 Content of the duty to act in good faith and reasonably

The usual content of the obligation to act in “good faith” is considered to be:

- 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 and to the provisions, aims and purposes of the contract, objectively ascertained.⁶

What is necessary to satisfy the duty will depend on the contractual and factual context (including the nature of the contract or contextual relationship). However, it does not place contracting parties in a fiduciary relationship and therefore does not require a contracting party to prefer the interests of the other contracting party, or to subordinate its self-interest. It is good faith or fair dealing between the parties by reference to the bargain and its terms that is called for.⁷

3 Excluding good faith obligations

While it is not possible to exclude an obligation to act “honestly” and “with fidelity to the bargain”, any additional obligation to act “reasonably” may be excluded either by express contractual provision or because it is inconsistent with the terms of the contract.⁸

4 Good faith in an era of uncertainty

Until the existence and content of the imposed duty to act in good faith and reasonably is resolved, the prudent course is:

- to exercise broad express contractual rights and discretions in a way that is consistent with the imposition of a duty of good faith and reasonableness (ideally for a legitimate, documented business reason); and
- to draft clauses appropriately where a broad express right or discretion is intended to not be subject to an obligation to act reasonably (or to otherwise expressly provide for the method and standard of exercise).

For example, a termination for convenience clause might appropriately be worded to allow a party to “terminate for any reason, at any time and in its absolute discretion”. This, together with

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a term expressly excluding all implied terms, would indicate the intention of the parties to exclude any good faith constraint that incorporates reasonableness in addition to honesty.⁹

5 Other fetters on contractual rights and discretions

Even if a duty of good faith and reasonableness is ultimately not found to be part of the law of performance of contracts in Australia, or is not found to apply in a particular case, the courts may still fetter broad contractual rights and discretions either as a matter of construction or by the implication of a term.

Some examples include:

- either as an implied term or a rule of construction, the courts will impose an obligation for each party to do all that is reasonably necessary to secure performance of the contract;¹⁰
- where one party has an express right or discretion, the exercise of which will significantly affect the interests of the other party if the holder of the power is satisfied that a certain state of affairs exists, the words of the contract are fairly readily construed as requiring a reasonable as well as honest state of satisfaction;¹¹ and
- a term can be implied that a party is not unreasonably to withhold its consent to an action or conduct by the other party. A similar term can be implied to a provision which contemplates that both or all of the parties will consent to a specified activity.¹²

ENDNOTES

¹ In *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5; (2002) 240 CLR 45, Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ at [40] recognised the “debate” but found that particular case would be an “inappropriate occasion” to resolve it. Kirby J (at [88]) and Callinan J (at [155]) also found it “unnecessary” to address the issue. In *CBA v Barker* [2014] HCA 32; (2014) 253 CLR 169, French CJ, Bell and Keane (at [42]) and Kiefel (at [107]) stated that their conclusion that an term of mutual trust and confidence was not implied into employment

contracts as a matter of law should not be taken as reflecting on the question of an obligation to act in good faith.

² The position has been described for example as “not settled” (*United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177 per Allsop P at [61], with whom Ipp and Macfarlan JJA agreed) and an “open question” (*Acton Real Estate Pty Ltd v Shemiran Pty Ltd* [2011] WASC 33 per Newnes JA, with whom Murphy JA agreed).

³ See *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177 at [61] in which the numerous previous authorities are cited. See also *Caswell v Sony/ATV Music Publishing (Australia) Pty Ltd* [2014] NSWSC 841; *JR Consulting & Drafting Pty Ltd & Anor v Cummings & Ors* [2014] NSWSC 1252; *Video Ezy International Pty Ltd v Sedema Pty Ltd* [2014] NSWSC 143. In *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd* [2012] NSWCA 184, Bathurst CJ (with whom Macfarlan and Meagher JJA agreed) held that the Respondent’s actions in not disputing that it was appropriate to imply into a joint venture agreement an obligation that the parties would act in good faith towards each other was “consistent with the approach adopted in a number of decisions of this Court” (at [144]); *Alstrom Ltd v Yokogawa Australia Pty Ltd* [2012] SASC 49 at [596].

⁴ See *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL & Ors* [2005] VSCA 228 per Warren CJ, Buchanan and Osborn JJA, confirmed in *Specialist Diagnostic Services Pty Ltd (formerly Symbion Pathology Pty Ltd) v Healthscope Pty Ltd & Ors* [2012] VSCA 175 per Buchanan, Mandie and Osborn JJA. See also *Tote Tasmania Pty Ltd v Garrott* [2008] TASSC 86 at [16], *Capital Aircraft Service Pty Ltd v Brolin* [2007] ACTCA 8 at [24].

⁵ See eg *Braganza v BP Shipping Ltd* [2015] UKSC 17; [2015] 1 WLR 1661 at [22], citing Rix LJ in *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116 at [66]; *Minister for Immigration and Border Protection v SZVFW* [2018] HCA 30; 92 ALJR 713 at [132] per Edelman J.

⁶ This summary by Allsop CJ in *Paciocco v ANZ* [2015] FCAFC 50 at [288] (with whom Besanko and Middleton J agreed) is said to be extracted from early NSWCA cases which can be seen as the foundation of the law of NSW on the duty of good faith in contractual performance (the issue was not considered in the (unsuccessful) appeal: *Paciocco v ANZ* [2016] HCA 28). The summary was also set out by Allsop P in *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 at [12]. See also the often-quoted formula suggested by Sir Anthony Mason, which has been said to be consistent with these Australian authorities: *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 at [146] per Hodgson JA (with whom Macfarlan JA agreed and Allsop P agreed subject to additional reasons).

⁷ *Paciocco v ANZ* [2015] FCAFC 50 at [289] and [290]. The issue was not considered in the (unsuccessful) appeal: *Paciocco v ANZ* [2016] HCA 28.

⁸ *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15.

⁹ As was the case in *Solution 1 Pty Ltd v Optus Networks Pty Ltd* [2010] NSWSC 1060 (applying *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15). See also *Bartlett v ANZ* [2016] NSWCA 30 where there was no implied restriction on an express power to terminate “for any reason” (per Macfarlan JA at [86]-[87] and Meagher JA at [106]-[107]; Simpson JA not deciding). See also *Questband P/L v Macquarie Bank Limited* [2009] QCA 266 at [66]. This has been cited with approval (although unnecessary for the decision) in *Platinum United II Pty Ltd v Secured Mortgage*

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Management Ltd (in liq) [2011] QCA 162. See also *Troupakis v Adams* [1999] FCA 609 at [7]-[9].

¹⁰ *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596; *CBA v Barker* [2014] HCA 32; (2014) 253 CLR 169.

¹¹ *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84; (1993) 117 ALR 393 at 403-4.

¹² *Servcorp WA Pty Ltd v Perron Investments Pty Ltd* [2016] WASCA 79.