

## **THE 2010 SIR FRANK KITTO LECTURE**

### **Good Faith and Australian Contract Law – A Practical Issue and a Question of Theory and Principle**

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Good faith in the Australian law of contract has been the subject of discussion and some controversy for twenty years. Much has been written on it. The lecture will seek to examine both the intensely practical as well as the theoretical considerations attending the notion. The lecture will seek to show not only the elements of the notion already well known to and part of Australian law, but also the forces operating that might be seen to require a more explicit recognition of the requirement in Australian contract law.

- 1 As I was preparing for this lecture in the last few months, at times I contemplated whether I had made a mistake with the topic. So much has been written about good faith in contracts that I thought a contribution from me would be of little value. (I may have been correct; you may judge that.) Nor was the topic one upon which Sir Frank Kitto dwelt. Apart from the march of time as my leave began to expire, I came to the view that I should persevere because of both the practical and theoretical importance of the topic. I hope Sir Frank would not consider the use of his name in conjunction with the following discussion other than entirely appropriate.

- 2 I have not sought to examine intimately the growing body of cases in Australia at the intermediate appellate level and first instance on the topic of good faith in contracts. The series of New South Wales Court of Appeal decisions from 1991 to 2001 (*Coal Cliff Collieries*,<sup>1</sup> *Renard Constructions*,<sup>2</sup> *Hughes Bros v Trustees of the Roman Catholic Church*,<sup>3</sup> *Alcatel v Scarcella*,<sup>4</sup> and *Hungry Jack's*<sup>5</sup>) and the influential views of Justice Paul Finn<sup>6</sup> and Sir Anthony Mason<sup>7</sup> saw good faith recognised as a sufficiently certain concept to found a legally enforceable obligation to negotiate in good faith and as the foundation of a duty that may be implied into a contract. Since then other intermediate courts have reacted with a mixture of caution<sup>8</sup> and doubt<sup>9</sup>. The current state of the authorities was analysed with great clarity by Steytler J (as he then was) in the Full Court of the Western Australian Supreme Court in *Central Exchange v Anaconda*.<sup>10</sup> The High Court has not spoken, the issue being left open in *Royal Botanic Gardens*.<sup>11</sup> In the meantime, the New South Wales Court of Appeal has reinforced the place of good faith by holding in *United Rail Group*<sup>12</sup> that an obligation to negotiate in good faith can be a sufficiently certain concept for contractual obligation, and by giving content to an express clause providing for the “utmost good faith” in a commercial contract in *Macquarie International Health Clinic*<sup>13</sup>.
- 3 Nor have I sought to survey the large body of academic scholarship in this field.<sup>14</sup>
- 4 What I have sought to do is to consider the practical and theoretical considerations attending a contractual obligation or principle of good faith and the significance of the concept of good faith in the Australian law of contract.
- 5 The practical importance of the question has at least two related elements, being the requirements of the community, principally the commercial community, for a satisfactory balance of certainty, fairness and common sense in the rules which govern the consensual relationships of its

members; and for the cost-effective, expeditious and just resolution of disputes by reference to such rules.

- 6 The theoretical importance lies in the foundational assumptions that underpin, or should underpin, our legal system and what the debate about the operation of good faith in our contract law tells us of our legal system, its state and development.
- 7 Of course, these two dimensions, the practical and the theoretical, inform each other. Commercial law is, or to a significant degree should be, the reflection of society's facilitation, not hindrance,<sup>15</sup> of commercial endeavour. That said, the norms that underpin a just and fair society and its legal system should underpin commerce. It is honest commercial endeavour that is to be facilitated not hindered, and it is the reasonable expectations of honest commercial men and women that are to be vindicated and protected. The law does not provide many rules for thieves and cheats, other than, rules against thieving and cheating. As Lord Shaw of Dunfermline said in 1924 in *Cantiare San Rocco SA v Clyde Shipbuilding and Engineering Co*,<sup>16</sup> a rule that leaves the loss to lie where it falls "works well enough among tricksters, gamblers and thieves". His Lordship recognised, with a touch of disdain, that this was the approach of the law of England as to the consequences of frustration of contracts. But, for Scotland, his Lordship saw a somewhat fairer rule, one that conformed more with honesty, reasonable expectations and fairness, under the law of restitution.
- 8 Before I turn to good faith, let me commence with some comments on what are sometimes seen as the competing considerations of certainty and generally expressed norms of conduct. I do so at the outset, because two things should be borne in mind at all times. First, no system of law and no system of commercial law can exist without generally expressed norms of conduct. Secondly, sometimes, a sensible rule can only be expressed coherently, and with any degree of certainty, using a generally expressed norm.

- 9 This paper concerns the question whether good faith is one of those norms in the law of contract in Australia.
- 10 One view of law and commercial law sees a system of value-free rules which can always be called upon and applied in a self-referential system providing the tolerably certain answer to the given problem. In such a system, practical certainty is said to be achieved by clarity of the value-free rule and its application to relevant facts, without the need for theoretical generalisation or morals. This is a pervasive, if not dominant, view in Australian courts. That is hardly surprising, since it reflects what occurs in many instances of adjudication.<sup>17</sup>
- 11 Certainty is a pervading human need. It takes its place from the earliest years of our existence, as a necessary environmental factor in our human relationships, with our parents, our siblings and our friends. In commerce, the need for certainty is founded upon a desire for clarity, efficiency and despatch in commercial dealings. Clarity and certainty enable risk to be priced more finely and more reliably aiding the operation of markets. Reduction of risk attending a transaction reduces transactional cost and tends to a lowering of price. This can increase total economic activity.
- 12 But certainty is not necessarily value-free. There have been few equals to Lord Mansfield in his understanding, and lucid expression, of commercial law. In 1761, in *Hamilton v Mendes*,<sup>18</sup> he famously said:
- “The daily negotiations and property of merchants ought not to depend upon subtleties and niceties; but upon rules, easily learned and easily retained, because they are the dictates of common sense, drawn from the truth of the case.”
- 13 This was not a call for rules shorn of values, but for simple rules reflective of the common sense and norms of the merchants. That was not, however, a call for moral or legal perfection. In 1774, in *Vallejo v Wheeler*,<sup>19</sup> the same judge said:

“In all mercantile transactions the great object should be certainty: and therefore, it is of more consequence that a rule should be certain, than whether the rule is established one way or the other. Because speculators in trade then know what ground to go upon”.

- 14 Lord Mansfield was well aware of the need for certainty, simplicity and clarity in markets that were fast-moving, international and subject to price variation and thus speculation.
- 15 Few modern judges have equalled Lord Diplock in his appreciation of the place of the law and the judge in regulating and fostering commerce in markets. His explanations in *The 'Maratha Envoy'*<sup>20</sup> of the place of standard form contracts in international markets such as the market for chartered ships and of the place of the court in interpreting contracts in such markets were commanding and illuminating, and worthy of reading, and rereading.<sup>21</sup> As his Lordship explained, standard forms and standard clauses permit comparison of different offers and the easy consideration of the commercial advantages and disadvantages of a proposed transaction, rather than of its legal attributes. The court's role is consistency and certainty in decisions, especially those attributing meaning to frequently used standard form contracts in markets.
- 16 One of the most telling points as to certainty in commercial law was made by Robert Goff LJ (as Lord Goff of Chieveley then was) in the Court of Appeal in the *The Scaptrade*<sup>22</sup> that it is important for the courts not to place obstacles in the way of parties knowing their position, if necessary with the aid of legal advice, without going to court. By this, his Lordship was recognising that the vast bulk of commercial justice is administered in conference with clients, not in court with judges.
- 17 Yet certainty, whilst very important, is not an overwhelming or dominating consideration in human existence. The certainty of a beating by a brutal father is as unwanted as the certainty of clear strict rules that overly favour

banker over customer, shipowner over charterer, franchisor over franchisee, or domestic over foreign merchant.

- 18 Whilst certainty is related to risk and its reduction, risk is not limited to lack of certainty. The high probability of being fleeced in a market with clear rules (because of the prevalence of aggressive sharp practice) is a risk factor likely to outweigh the benefit of clarity of rules.
- 19 People, including commercial people, expect a degree of common sense, fairness and justice in the law and in the rules that govern commercial behaviour. The place of morals and norms of justice in any legal system is an important jurisprudential and theoretical question.<sup>23</sup> It is also an intensely practical day-to-day question. People, including business people, understand notions of honesty, fairness and justice in their dealings. They often have a different view as to what this produces at the point of any given dispute, but the notions inhere in human conduct and expectations. A balance must always to be struck between specific rule-based certainty and the application of generalised norms informed by honesty, reasonable expectations and fairness.
- 20 Honesty is an essential requirement of any commercial market. Honesty is a moral concept, the core elements of which are truth and moral rectitude. It is unnecessary, however, to explore the reaches of moral philosophy to accept, as a working hypothesis for development of practical legal rules, that honesty is a relative, and not absolute, concept for this purpose. Just as markets may be seen to have, or not to have, workable degrees of competition, so they may have workable degrees of honesty. One only has to recall the dictum of Cardozo CJ in *Meinhard v Salmon*<sup>24</sup> comparing acceptable conduct in the workaday world of the market with the fiduciary's "punctilio of an honour" to appreciate the relativity of the concept. Nevertheless, it is an essential norm for the reduction of risk and the maximisation of efficient economic activity. One rarely hears a party or a judge say "but what is honesty?". ("What is truth?", on the other hand, has been asked from time to time.<sup>25</sup>)

- 21 Honesty is a concept wide enough to include, but not be exhaustively defined by, a subjective or personal sense of right and wrong. Honesty can, though not necessarily must, incorporate the imputed or imposed standards of others: the “normally acceptable standards of honest conduct”,<sup>26</sup> judged by reference to what the person actually knew. This is a broad normative standard to be judged by reference to community or market expectations and standards of conduct.
- 22 The balance between specific value-free rules and honest conduct is, or should be, self-evident: the former are constrained by the latter. Although certainty may, thus, on one view, be compromised, this occurs for a fundamentally important consideration – the honest working of society and commerce. In a sense, certainty (by reference to reasonable expectations) is strengthened by the moral content. For instance, when should the strict and clear contractual obligation of a banker to obey the mandate of its customer be qualified by reference to the character or quality of the conduct of the customer? The New Zealand Court of Appeal recently answered the question by reference to whether the customer’s conduct reflected “normally acceptable standards of honest conduct.”<sup>27</sup> More precise definition of “acceptable” in this context in furtherance of rule-based certainty is only likely to elevate factual applications of the legal norm into narrower and more intricate rules.
- 23 The confusion between factual application of the legal rule, on the one hand, and the overly precise identification of multiple legal rules, on the other, often occurs. It can produce a plethora of “rules” and incoherence and confusion in the law, which itself is productive of uncertainty. (Many modern statutes exhibit this vice.) Thus, at important points of rule-making, there is no choice but to leave the rule expressed generally, if the only alternative is to express a multitude of exemplifications of factual applications as rules. In other words, in some contexts and with some rules, the sensible vindication of Lord Mansfield’s statement in *Hamilton v Mendes* that rules for commerce should be easily learned and easily

retained, means that certainty, to the extent it is possible, is fostered, not undermined, by the use of the generally expressed norm. It is sometimes the only way of expressing the sensible commercial rule.

- 24 The recognition of the importance of honesty takes us some way down the path of discussing good faith. Good faith includes honesty. The original American Uniform Commercial Code (“UCC”) defined good faith as “honesty in fact in the conduct or transactions concerned”.<sup>28</sup> This was later revised to “honesty in fact and the observance of reasonable commercial standards of fair dealing”.<sup>29</sup> I will return to these notions in due course. It is enough to understand the central place of honesty in good faith.
- 25 Further, no legal construct governing commercial behaviour can entirely eschew norms beyond honesty that are generally expressed and informed by standards of the relevant group. The balance between specific value-free rules and generally expressed norms is a judgmental one based on legal tradition, legal technique, the perceived importance and value of the inter-related operation of these factors and a knowledge of the expectations and standards of the community or market governed by the legal construct.
- 26 The balance for any legal construct between specific value-free rules and generally expressed norms depends significantly on the values of the community served by the construct. It might be thought that the smaller or more coherent, culturally and socially, is the community governed by the construct, the fewer disputes there are likely to be about how a generally expressed norm should operate. It should be recalled, however, that how a generally expressed norm will operate in any given contract will depend upon the terms in which it is expressed, the other express terms of the contract and, importantly, the context in which the contract is made. The parties in their mutual milieu make their own law.

- 27 Another practical consideration which silently, but in a real way, influences the development of law and legal principle is the available means of dispute resolution. The rules of a legal system must be able to be the subject of adjudication efficiently and justly. An important consideration for assessing efficiency and justice is the cost of dispute resolution. It is neither efficient nor just to inflict expensive dispute resolution on parties; and if the formulation of a rule is likely to produce that result, such weighs heavily against it as a rule to be adopted.
- 28 There are many examples in commercial law of mechanical or value-free rules giving way to a norm or principle that is more evaluative in foundation whether because that is the chosen compromise or because the generally expressed norm best expresses a simple rule. Two recent examples and one older example in commercial law illustrate the point. In *The 'Golden Victory'*<sup>30</sup> the House of Lords considered the methodology for calculation of damages for breach of contract – in the case at hand a time charter of a ship (*Golden Victory*). By majority, the simple rule of assessing loss at the date of termination for breach by reference to the market rate gave way to taking into account later events to give a fairer or more just amount in compensation.
- 29 In *The 'Achilleas'*<sup>31</sup> in the House of Lords, Lord Hoffmann in dealing with contractual damages saw a need to move away from mechanistic application of otherwise clear rules based on *Hadley v Baxendale*<sup>32</sup> and *Koufos v Czarников*<sup>33</sup> and to approach the calculation of damages in contract by reference to more general notions of reasonable conformance with the substance of the underlying bargain. Lord Hoffmann, rather than applying the test of foreseeability, posited, as the primary question in deciding whether loss was recoverable in contractual damages, the ascertainment of the risks, and thus the losses, which the parties' intentions (objectively ascertained) revealed had been bargained for as part of the contract. Thus, the assessment was whether a reasonable person at the time of making the contract would have contemplated the assumption of responsibility for that kind of loss.

- 30 In marine insurance, the notion of discharge of the insurer from liability is central to the operation of the promissory warranty<sup>34</sup> and to the operation of the principles of deviation<sup>35</sup> and delay<sup>36</sup>. The discharge of the insurer will see the assured lose, for all time, the benefit of the contract of insurance. If there is delay in a voyage covered by a voyage policy the rule is expressed generally: “the insurer is discharged from liability as from the time when the delay became unreasonable”.<sup>37</sup> The rule, easily learned and easily retained, is expressed in general terms.
- 31 The above cases are examples of the preferred use of rules that have a degree of evaluation and uncertainty to them which are adopted for reasons of commercial fairness or appropriateness, or because that is the only way simply to express the rule.
- 32 Let me return to good faith.
- 33 Good faith is an expression that includes honesty, but goes beyond it. What place should it have in our law of contract?
- 34 I will seek to answer this question by reference to the following considerations:
- (a) the content of the phrase;
  - (b) the extent to which it exists already in our law;
  - (c) the forces within, and external to, Australia pressing on our contract law conformable with its inclusion;
  - (d) considerations of legal technique in the modification of the law of contract;
  - (e) considerations of legal theory.

## The content of the phrase good faith

- 35 Before examining the related elements that can be put forward as attributes of the phrase, it is important to recognise that a process of characterisation of the relevant transaction and legal relationship is necessary at the outset. If the legal relationship is one involving a trust or fiduciary relationship, the notion of good faith takes on particular attributes that are well-known and not the subject of this discussion. The criteria by reference to which the fiduciary relationship is recognised do not lead to a simple test without conceptual difficulty.<sup>38</sup> However, a helpful (if incomplete) step in ascertaining whether a fiduciary relationship exists is the characterisation of the relationship as commercial or not.<sup>39</sup> The characteristic aspect of the duty of the fiduciary is, within the terms of the relationship, to subordinate its interests in favour of its beneficiary. This subordination will be derived from the degree of power and control and consequent vulnerability of the respective parties in the relationship.
- 36 The usage of the phrase good faith in this equitable context should not give rise to the notion that in a commercial non-fiduciary context it carries with it the obligation upon a contracting party to subordinate its interests to those of the arms' length contractual counterparty. That is not the case. The possibility of confusion with the incidents of faithfulness of the equitable fiduciary have led some (wisely I think) to prefer other terminology: fidelity to the bargain<sup>40</sup> and fair dealing<sup>41</sup>. These are terms to which I will return.
- 37 In a common law context it is difficult not to begin by reference to the position in the United States.
- 38 In the 19<sup>th</sup> and early 20<sup>th</sup> centuries in some States, notably New York, and in the United States Supreme Court, a common law doctrine of good faith was recognised.<sup>42</sup> In 1868, in *Railroad Company v Howard*, Justice Clifford speaking for the Supreme Court said:

“Corporations as much as individuals are bound to good faith and fair dealing, and the rule is well settled that they cannot, by their acts, representations and silence, involve others in onerous engagements and then turn around and disavow their acts and defeat the just expectations which their own conduct has superinduced”.<sup>43</sup>

39 As I will later discuss, the expression of the matter thus reflects a reach of the concept intrinsically tied to, and constrained by, the contract entered and to the honest and fair performance of what has been agreed, rather than the superimposition of moral values having their source and legitimacy outside the contract, and operating beyond the agreement of the parties. These 19<sup>th</sup> century cases persuaded Judge Posner to say in 1991 that the contractual duty of good faith in its modern form was “*not some newfangled bit of welfare-state paternalism or ... the sediment of an altruistic strain in contract law [its essentials] being well-established in nineteenth century cases*”.<sup>44</sup>

40 The modern conception of good faith in American law, however, can be traced to the legal realist, Professor Karl Llewellyn who was the Chief Reporter for the UCC and an influential figure in the drafting of the *Restatement (2d) of Contracts*. The textual underpinnings for good faith in the United States are the UCC and the American Law Institute’s *Restatement (2d) of Contracts*.

41 The UCC § 1-203 provides:

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

42 Many of the UCC provisions mention good faith.

43 I have already referred to the definition of good faith in the original § 1-201(19) and the later § 1-201(20). There are other variants of the duty in parts of the UCC, such as § 2-103(1)(b) in respect of sale of goods: “*honesty in fact and the observance of reasonable standards of fair*

*dealing in the trade*"; and in § 3-103(a)(4) in respect of negotiable instruments, good faith is defined as "*honesty in fact and the observance of reasonable commercial standards of fair dealing*".

44 In the *Restatement (2d) of Contracts*, § 205 reads, "Every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement".

45 These provisions have led to a large body of decisions in many American jurisdictions, not always easy to reconcile with each other.

46 Leading scholars have viewed the operation of the principle from different perspectives. In 1968, Professor Robert Summers published an influential article in which he expressed the content of the obligation as an "excluder analysis" – good faith ruled out or excluded certain kinds of bad faith.<sup>45</sup> Good faith had no stable content, other than to exclude bad faith. The commentary to the *Restatement* took this up in the discussion of § 205.<sup>46</sup>

47 In 1980, Professor Steven Burton published a major article introducing a "forgone opportunity analysis".<sup>47</sup> This was a standard intended to be limited to the bargained-for expectation of the parties.

48 Meanwhile, Professor Allan Farnsworth, from 1963 expressed the view that good faith was an expression of the existing underlying principles of contract law and its role was particularly in the implication of terms.<sup>48</sup>

49 I will return to the American position in due course. For the moment, I will return to the expressions "fidelity to the bargain" and "fair dealing" and seek to analyse them by reference to more familiar jurisprudence and general principle.

50 Together with honesty, these two expressions best convey the non-fiduciary contractual obligation arising from the two main sources of principle in the law of contract: the exercise of the will of the parties and

the legal, social and moral context in which that will is recognised, interpreted and enforced.

- 51 Few have difficulty with good faith in the form of honesty being a general and imputed contractual obligation. Few also have difficulty with good faith requiring the bargain not to be consciously undermined or sabotaged. This can be seen as a staple obligation of contract law, expressed in terms that are sufficient without the moral overtones of good faith. The notion of a fidelity or faithfulness to the bargain better encapsulates this operative principle. It was at the core of what Justice Clifford said in *Railway Company v Howard*. It was at the heart of what was said in 1864, in *Stirling v Maitland* by Cockburn CJ:<sup>49</sup>

“if a party enters into an arrangement which can only take effect by the continuance of a certain existing state of circumstances, there is an implied engagement on his part that he shall do nothing of his own motion to put an end to that state of circumstances, under which alone the arrangement can be operative.”

- 52 This was an expression of a negative by implication. Some years later, Lord Blackburn in *Mackay v Dick* expressed a similar idea by reference to the process of construction of the contract and by reference to positive action:<sup>50</sup>

“[if] ... parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing though there may be no express words to that effect.”

- 53 These ideas were eloquently (and, if I may say so, more powerfully) expressed in Australia in 1896 in the Supreme Court of Queensland by Chief Justice Griffith in *Butt v M'Donald*.<sup>51</sup> He stated a general rule of somewhat broader reach than either that stated by Cockburn CJ or by Lord Blackburn:

“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 to have the benefit of the contract.”

54 It might be thought that by this expression of the matter – “the benefit of the contract” – that is, what each has bargained for, received, given up and paid for was protected, in all contracts, by a general rule of implication. Support for this came from what Dixon J said in *Shepherd v Felt & Textiles of Australia Ltd*<sup>52</sup> that, contained within every express promise, is a negative covenant not to hinder or prevent the fulfilment of the purpose of the express covenant.

55 It is necessary, however, to examine carefully the judgment of Mason J (with whom Barwick CJ, Gibbs Stephen and Aickin JJ agreed) in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Limited*.<sup>53</sup> After referring to *Mackay v Dick* and *Butt v M'Donald*, Mason J discussed the implication of a contractual duty to co-operate. He said<sup>54</sup> that it was easy to imply a duty to co-operate contractually in the doing of acts which are necessary to the performance of **fundamental** obligations under the contract. It was, he said, “*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 the contract but are not essential to the performance of that party’s obligations and are not fundamental to the contract.*” At this point the importance of implication or imposition of a rule and construction of a particular contract became important. Mason J continued:

“... Then the question arises whether the contract imposes a duty to co-operate on the first party or whether it leaves him at liberty to decide for himself whether the acts shall be done, even if the consequence of his decision is to disentitle the other party to a benefit. In such a case, the correct interpretation of the contract depends, as it seems to me, not so much on the application of the general rule of construction as on the intention of the parties as manifested by the contract itself.”

56 I am, of course, still dealing with the content of good faith, not with the legal technique or mechanism that leads to its presence, or absence. The distinction made by Mason J between the benefit of fundamental or

essential terms and of non-fundamental or non-essential terms may throw doubt upon the entire equivalence of his approach with a more general obligation of fidelity to the bargain that can perhaps be seen in Chief Justice Griffith's expression of the rule in *Butt v M'Donald*. If such a more general obligation subsists, its breach would prima facie occur when a party acted in a way to deny a contractual benefit to the counterparty, whether fundamental or not.

- 57 In any given case, it may or may not be reasonable to expect a party to act, or refrain from acting given the expense or risk of the act, to ensure the benefit to the counterparty. Thus notions of fidelity to the bargain and co-operation to vindicate, or ensure receipt of, benefits can be seen to be restrained or constrained by a sense of reasonableness or fair dealing arising from the parties' mutual rights.
- 58 This is the proper scope and reach of reasonableness in good faith and fair dealing: the element of commercial reasonableness and fairness in behaving with a faithfulness or fidelity to the bargain. As Lord Wright said in *Hillas and Co Ltd v Arcos Ltd*,<sup>55</sup> the legal implication of what is reasonable runs throughout the whole of English law and is easily made.
- 59 Recently in *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service*<sup>56</sup> Hodgson JA in dealing with the content of the phrase "utmost good faith" in express terms in the subject contracts adopted what Sir Anthony Mason had said in a paper in 2000 that a contractual obligation of good faith embraced the following notions:
- (1) an obligation on the parties to co-operate in achieving the contractual objects;
  - (2) compliance with honest standards of conduct; and
  - (3) compliance with standards of conduct that are reasonable having regard to the interests of the parties.

Hodgson JA saw these elements as consistent with the cases in the New South Wales Court of Appeal, in particular *Alcatel v Scarcella* and *Hungry Jack's*. His Honour, however recognised that:<sup>57</sup>

“ ... a contractual obligation of good faith does not require a party to act in the interests of the other party or to subordinate its own legitimate interest to the interests of the other party; although it does require it to have due regard to the legitimate interests of both parties”.

60 The usual content of the obligation of good faith that can be extracted from the New South Wales Court of Appeal cases referred to above can be expressed as follows:

- (a) obligations to act honestly and with a fidelity to the bargain;
- (b) obligations not to act dishonestly and not to act to undermine the bargain entered or the substance of the contractual benefit bargained for;
- (c) 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.

61 These obligations do not require subordination of a party's own interests, to those of the contractual counterparty. The content and scope of the obligation depends upon the other terms of the contract and the context in which the contract was made. Reasonableness takes its place as an objective element in fair dealing together with honesty and fidelity to the bargain in the furtherance of the contractual objects and purposes of the parties, objectively ascertained.

62 In *United States Surgical Corp v Hospital Products International Pty Ltd* at first instance<sup>58</sup> McLelland J (as he then was) examined New York law and accepted the evidence of Judge Breitel as to the interpretation of § 205 of

the *Restatement (2d) of Contracts*. McLelland J concluded that the approach of New York courts to § 205 did not materially diverge from the law of Australia as expressed in *Secured Income Real Estate* and *Butt v M'Donald*.

- 63 Gummow J in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd*<sup>59</sup> adopted these views. What Gummow J drew from them, however, was that they supported an approach not to recognise a general obligation of good faith, rather than one to recognise it.
- 64 As noted above, however, the reach of the obligation of good faith may exceed the principle expressed in *Secured Income* if the latter is predicated on only protecting the benefit from fundamental terms. The protection of the benefit derived from non-fundamental terms by a general obligation of good faith may be a material addition to the parties' contractual entitlements and obligations.
- 65 The phrase good faith is, however, capable of being given a much broader reach, as a general obligation to make disclosures of candour and to act fairly and reasonably, generally, by the imposition by the court (through the law) of a obligation so to act – even if it goes beyond, or is inconsistent with, the agreed terms of the parties' contract.
- 66 An example may be taken from Germany. Whilst an analysis of the operation of § 242 of the German Civil Code of 1900, with its apparently narrow expression of good faith<sup>60</sup> is beyond this paper, it is to be noted that it was used in Weimar Germany to revalorise nominal monetary obligations in the face of catastrophic inflation. As Zimmerman and Whittaker say<sup>61</sup> these decisions hit the German legal community like a bombshell.
- 67 At this wider level, the obligation, if it exists, may require general pre-contractual disclosure to a degree which makes bargaining take place on an equal foundation of information and may require that the parties deal

reasonably and fairly with each other, quite apart from the other provisions of the contract, as an independent obligation.

- 68 The legitimacy of, and the likely acceptance of, such a broader imposed norm depends upon the theoretical framework from which one works. It is at this point one needs to consider some of the theoretical underpinnings of a law of contracts, to which I will come shortly. Also important for the common law is the recognition of the need for judicial method and technique in the formation, interpretation and performance of contract.

### **The extent to which good faith subsists or its elements subsist in Australian law**

- 69 Good faith infuses, and its constituent elements infuse, Anglo-Australian law, both public and private law. Whilst time and space permit only a present concentration on the law concerning contracts, it is apt to recognise that the expression “good faith” is embedded in public law,<sup>62</sup> equity and trusts,<sup>63</sup> property<sup>64</sup> and company law,<sup>65</sup> taking its meaning and legal content in those areas from context and the incidents of relationships governed by law and equity.
- 70 In contract law, I have already discussed some of the co-ordinate notions in *Mackay v Dick*, *Secured Income* and *Shepherd v Felt Textiles*. There are, however, a body of cases in contract that deal with the exercises of powers or discretions which affect the counterparty. These cases reveal that there is no novelty whatsoever in constraining powers and discretions by implications of honesty, reasonableness and good faith. Examples are numerous.
- 71 In *Meehan v Jones*,<sup>66</sup> all the members of the High Court implied an obligation to act honestly in a clause providing a party a right to rescind unless satisfied with finance. A majority of the Court concluded that the party also had an obligation to do all that was reasonable to obtain that finance.

- 72 In *Stadhard v Lee*,<sup>67</sup> Cockburn CJ said that building contract clauses dealing with the satisfaction of a party about a state of affairs received “a *reasonable construction* [securing] *only what was reasonable and just*” .
- 73 In *Carr v JA Berriman Pty Ltd*,<sup>68</sup> Fullagar J construed a clause giving an architect “*absolute discretion ... to issue written instructions ... in regard to the omission of any work*” by reference to its purpose and a limitation of reasonableness.
- 74 In *Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd*,<sup>69</sup> the High Court dealt with cl 14 of the then standard form contract for the sale of land: the clause providing to the vendor who was unable or unwilling to comply with or remove any objection or requisition made by the purchaser with the entitlement to rescind. The use of the clause was confined by the Court by various expressions of value judgment. Barwick CJ<sup>70</sup> said it would be “unconscionable” for the vendor to use cl 14 on the particular requisitions – to permit him to do so would allow him to say that there was a sale conditional on his willingness to perform. Walsh J<sup>71</sup> recognised that the cases prevented the power being used arbitrarily or unreasonably. Gibbs J<sup>72</sup> constrained the clause by the need to act reasonably. Stephen J<sup>73</sup> employed notions of proper purpose and reasonableness.
- 75 Similar views were expressed on the same subject in *Pierce Bell Sales Pty Ltd v Frazer*.<sup>74</sup>
- 76 All this sounds very much like the elements of good faith.
- 77 In *Interfoto Library Ltd v Stiletto Ltd*,<sup>75</sup> Bingham LJ explained the English approach to good faith. He compared civil law systems’ acceptance of an over-riding obligation to “play fair” – a principle of open and fair dealing. English law, on the other hand, has committed itself to no such general principle, developing piecemeal solutions to demonstrated problems of unfairness.

- 78 Lord Wilberforce made a similar comment in *The 'Eurymedon'*<sup>76</sup> that English law had committed itself to a technical and schematic doctrine of contract. See also Lord Hope of Craighead in *R (European Roma Rights Centre) v Immigration Officer, Prague Airport ('The Roma case')*.<sup>77</sup>
- 79 There is no doubt, however, that our law, including the law of contract, is littered with principles, rules and approaches which have as their elements what can be seen as the elements of good faith. What might be said to be absent is the recognition of an expressed norm reflecting its presence as an informing principle.

#### **Internal and external forces pressing for the inclusion of good faith into Australian contract law**

- 80 The domestic and international forces on our law of contract have different but related sources and influence.
- 81 Domestically, in conformity with much of the developed world, we live in a society that expects more justice and accountability. We all experience this daily. Our statute law abounds with provisions requiring persons in and out of commerce to behave fairly or calling for fairness. The *Trade Practices Act 1974* (Cth), the State and Territory equivalents, their attached franchise provisions, and the *Contracts Review Act 1980* (NSW) are but examples. Some statutes require good faith negotiation.<sup>78</sup>
- 82 These provisions, together with the law of unconscionability, equitable estoppel and promissory estoppel, rarely permit injustice to go unremedied, but importantly, sometimes, indeed perhaps too often, do not permit uncomplicated litigation. Thusfar it is a balance of justice, time and cost that society appears to accept.<sup>79</sup>

- 83 Further, and equally pressing, there is the more frequent use of the phrase good faith in express contracts. I state this at an anecdotal level only. In both *United Group Rail*<sup>80</sup> and *Macquarie International Health*<sup>81</sup> the Court was dealing with express clauses in carefully considered written commercial contracts. The business people and advisors who drafted and agreed to these contracts apparently thought the words meant something. In accordance with well-known authority,<sup>82</sup> the Court should strive to give effect to business contracts where there is a meaning capable of being ascribed to a word or a phrase. Good faith is not a meaningless phrase. It is potentially wide and indeterminate in practical application without context; but context, including other terms, and an eye to fostering the commercial bargain will assist with its meaning in any given circumstance.
- 84 Courts must deal with a meaningful phrase in express terms, in its proper context. It might be seen to be an inadequate response if the courts say that its content is vague or uncertain. If the commercial parties use the phrase to express an obligation, commercial judges should do their best to give it the meaning it bears in the context in which it is found.
- 85 The international pressures on our law and legal systems are subtle but real. The description of world commerce as globalised is a cliché. It has been now for decades. What has accompanied that globalised or transnational commercial activity is transnational international dispute resolution and statements of transnational norms or rules.
- 86 International arbitration is a de-localised non-sovereign mechanism of resolving disputes that is used in over three quarters of international commercial disputes. Its importance is to be recognised by the capacity for a general law merchant or *lex mercatoria* to develop outside national courts.<sup>83</sup>
- 87 The pace of development of international commercial law has been remarkable in the last 20 to 30 years. There are international and European restatements, model laws, principles, conventions, directives

and other instruments on contract law,<sup>84</sup> electronic commerce,<sup>85</sup> international sale of goods,<sup>86</sup> agency and distribution,<sup>87</sup> international credit transfers and bank payment undertakings,<sup>88</sup> international secured transactions,<sup>89</sup> cross-border insolvency,<sup>90</sup> securities settlement and securities collateral,<sup>91</sup> conflict of laws,<sup>92</sup> international civil procedure,<sup>93</sup> and international commercial arbitration.<sup>94</sup>

88 Some of these instruments are not legally operative, whether at the level of public international law, or municipal law. Such model laws or principles are sometimes referred to as “soft” law.

89 These conventions, model laws and principles, even if they are only so-called “soft” law, provide rules and principles of a greater or lesser degree of international acceptance in respect of important elements of commercial life: contracts (and their formation, interpretation and performance), the sale of goods, payment and credit, arbitration and civil procedure. These can be used by parties, by arbitrators and by judges as aspects of accepted international approaches to common international transactions. They can also be incorporated into contracts as the rules of procedure or as part of a party-chosen governing law.

90 At the heart of a number of these instruments is good faith. Arguably, it is to be recognised as an attribute of modern international commercial law, as it was of the law merchant.<sup>95</sup> For instance, good faith is avowedly an ethical ambition of the UNIDROIT principles of contract law.<sup>96</sup> These principles are designed to be used by commercial people all around the world. The view embodied in the principles is that they should have an ethical foundation common to all – good faith and fair dealing is such a basal idea.

91 This finds its manifestation in a number of places in the UNIDROIT Principles. Article 1.7 provides that “*each party must act in accordance with good faith and fair dealing in international trade.*” The duty is stated **not** to be derogable. It is frequently referred to in international commercial

arbitration.<sup>97</sup> No definition is given, but its place with “fair dealing” naturally imports an objective sense.

92 Articles 3.5 and 3.10 use the notion of “reasonable commercial standards of fair dealing” in dealing with mistake and rescission.

93 Negotiations are regulated by Art 2.1.15. A party is free to negotiate but must not negotiate or break off negotiations in bad faith. Bad faith is exemplified by entering into or continuing negotiations intending not to reach an agreement. The negative (bad faith) and the exemplification are indications that this is principally an obligation of honesty and genuineness. The notion of negotiating in good faith is well-known in civil law systems.<sup>98</sup>

94 Good faith and reasonableness also attend contract interpretation in the UNIDROIT principles, but in a way we would find more familiar. Article 4 deals with interpretation. Articles 4.1-4.3 introduce the parties’ actual intentions into the interpretive process. This is contrary to our objective construct.<sup>99</sup>

95 Articles 4.4-4.7 deal with interpretive approaches that reflect our law.<sup>100</sup>

96 Importantly, good faith plays a part in implication of terms in Arts 4.8 and 5.1.2. It is one of the factors considered in implying terms in appropriate circumstances.<sup>101</sup>

97 Good faith and fair dealing find their place in contract performance. Article 5.1.3 requires the parties to co-operate with each other where such may reasonably be expected for the performance of that party’s obligations.

98 There are many requirements of reasonableness.<sup>102</sup>

99 None of this is foreign to our system or our contractual conceptions.

- 100 The Principles of European Contract Law provide for good faith in similar fashion. Articles 1.201 and 1.202 contain general duties to act in accordance with good faith and fair dealing and to co-operate in order to give full effect to the contract.
- 101 More directly relevant is the *United Nations Convention on Contracts for the International Sale of Goods* 1980 (“CISG”). This convention has been adopted into Australian domestic law by every State and Territory.<sup>103</sup> The CISG applies only to international sales of goods, but that, for Australia, one of the world’s great commodity exporters, is a fundamentally important matter. There is no generally stated obligation of good faith. Art 7, however, in dealing with interpretation of the Convention, says:
- “... regard is to be had to its international character and the need to promote uniformity in its application and the observance of good faith in international trade.”<sup>104</sup>
- 102 The consequences of the insertion of good faith by this clause is a matter of debate<sup>105</sup>; but what is clear is the acceptance by the CISG of the notion as fundamental in international commerce, and the adoption of the CISG in our domestic law.
- 103 A number of pressures build up from these domestic and international factors. First, it is an expectation both domestically and internationally that the law will coherently express underlying basal norms that inform it. Secondly, good faith in the sense of fair dealing, fidelity to the bargain and reasonableness inform and infuse our law already. That might be seen as a reason for expressing the norms more coherently, rather than for not expressing them at all.
- 104 International trade and commerce (as is the case in all commerce) is built on honesty, a degree of trust and managing risk. Distances, unfamiliar counterparties, unfamiliar customs and unfamiliar legal systems lead to a desire for accepted and common norms of ethical behaviour and a lack of particularity or parochialism in the governing rules. That is one reason for

the preference for arbitral tribunals over national courts. International norms are preferred to local ones. Good faith and fair dealing are norms found in the law merchant over the centuries, found in contemporary legal systems, including our own, and found in international conventions and statements of principle concerning commercial law.

- 105 A legal system which consciously eschews expression or open recognition of the norm may perhaps risk being viewed (perhaps wrongly) as particularist and exceptionalist. In such circumstances, its law, its lawyers and its ability to participate in international dispute resolution may be viewed with some skepticism and thus compromised, unless, like English law, it has an overwhelming stock of good will.

### **Legal technique**

- 106 The courts do not legislate nor are they law reform agencies.<sup>106</sup> Judges apply judicial method and technique. The place of policy and legal theory in the declaration, development and rationalisation of judge-made law is a topic in itself. Sir Frank Kitto in his luminous and oft referred-to judgment in *R v Spicer; Ex parte Australian Builders' Labourers' Federation*<sup>107</sup> spoke of power intended to be made upon considerations of general policy and expediency as alien to the judicial method, and thus non-judicial. That should not be misunderstood. In *Attorney-General (Cth) v Alinta Ltd*,<sup>108</sup> Gleeson CJ made clear that Kitto J was not propounding a mechanical application of inflexible rules, without regard to wisdom and expediency. The common law, Gleeson CJ said, was judge-made:

“ ... and its development and rationalisation necessarily involve attention to such questions. Furthermore, many of its settled principles, in their application to changing circumstances and social conditions, require judgment about what is wise and expedient”.

- 107 The need for courts to act incrementally building on the past using a judicial method of analysis is not inimical to the recognition of society's

needs and the policy formulation that inheres in a role of adaption and development of law to contemporary society.<sup>109</sup>

- 108 In Australia, the notion of good faith has been recognised at the level of intermediate courts of appeal in the performance of contracts,<sup>110</sup> in the negotiation of contracts<sup>111</sup> and in the settlement of disputes.<sup>112</sup> It is recognised as part of international trade by domestic statutes. Its elements and its place as a concept are recognised throughout law, equity and statute. Internationally, it is (as it has been for centuries) widely recognised as an operative legal norm.
- 109 It is not a large step to recognise the notion generally as an informing principle, expectation or maxim of the common law. As a general rule, parties are assumed and expected to act in a manner consistent with honesty and the reasonable expectations created by them. The vindication of contractual rights and duties thereby created in a manner consistent with a fidelity or faithfulness to any bargain entered should be an aim of the law of contract.
- 110 Nor is it a large step to recognise that “necessity” or “necessary” for business efficacy inheres in fair dealing and vice versa. Efficacious in a business sense includes a notion of fair dealing, if that is an underlying recognised norm. The important analysis by Priestley JA in *Renard*<sup>113</sup> of necessity in this context reveals the circularity that can attend rejection of an implication of good faith because of the need to show necessity for business efficacy.
- 111 If one accepts that honesty, fair dealing and fidelity to the bargain as entered are basal elements of commerce, the recognition of that can manifest itself in a number of ways. It would always inform the interpretation of a written contractual instrument; on this basis there would be seen to be no difference between the approach of Mason J in *Secured Income* and Griffith CJ in *Butt v M'Donald*. It would always inform the consideration of the formation of contracts, in particular those that are not

contained in an apparently comprehensive document.<sup>114</sup> It would be a ready implication in many contracts, at least as a matter of fact.

112 Debates continue about method and mechanism.<sup>115</sup> The real issue, however, is the recognition of the reality and existence of the norm itself and its conformance to governing legal theory. Within the resolution of that issue one finds the true content and scope of the phrase for general application.

### **Legal theory**

113 Law, legal doctrine and legal method are underpinned by legal theory.

114 How one views the legal system and the legal theory underpinning it to a significant degree governs the formulation of the answers to legal questions, such as the role of good faith in contract law.

115 For instance, a view that contract derives from the will of the parties assists in understanding why they should be bound (whether as a matter of decency based on natural law, or pursuant to an individualist notion of will and right) and in understanding how the law should approach their compact and their promises.

116 An underpinning conception or theory that would justify or make sensible a general obligation to disclose information in pre-contractual negotiations or to behave fairly and reasonably in a transaction irrespective of its terms, properly construed, might have a number of features. It would or could include the view that consent required more than formal manifestation and to be “true” consent required a reasonable degree of equality of knowledge. Such symmetry of information may require disclosure to bring it about. It would or could include a view that equality of exchange involved not only symmetry of information, but also equality of exchange and a just price. If such matters were included in the theory underpinning

contract, they would reflect essential or immanent characteristics of the contract as a institution or end informing its essence or being.

- 117 The above elements can be seen underlying pre-19<sup>th</sup> century natural law theory derived from Aristotle and Aquinas, revived in 16<sup>th</sup> and 17<sup>th</sup> century Spain and taken up by the northern European natural law theorists, including Grotius, Pufendorf and Pothier.<sup>116</sup>
- 118 These became problematic notions with the rise of individualism, individual responsibility, competition and market theories of Locke, Mill, Bentham, Adam Smith, Spencer and Darwin. Social contractarianism gave way to individualism and laissez faire economic and political ideas. English legal theory came to be dominated by the legal positivism of John Austin.<sup>117</sup>
- 119 The will theory that had been part of natural law became adapted by the abandonment of moral notions of a just price or equality of exchange. The will and intention of the parties was as objectively manifested to set price and terms as part of contracts becoming mechanisms of risk allocation. Contracts were no longer merely the reflection in the law of obligation of the transfer of property and executed performance; rather, the contract, in its paradigm form, became the exchange of promises by individuals. The promise was not a moral duty, but an exercise of individual free will in the allocation of risk.<sup>118</sup>
- 120 These ideas reflected the movement away from a society whose economic activity was founded upon the physical transactions of land and goods to one whose economic activity was founded to a greater degree on markets and the consequent commercial need for risk allocation. If the paradigm is the exchange of promises to fix a risk by reference to promises, the notion of a just price or an equal exchange becomes problematic.
- 121 Lord Mansfield expressed the view in *Carter v Boehm*<sup>119</sup> in relation to all contracts:

“Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary ...”

- 122 That no longer holds true for contracts generally. It is, of course, the foundation of the general law of insurance. It can also be seen to inhere in contracts to do with the transfer of land in the vendor’s duty to disclose latent defects of title.<sup>120</sup>
- 123 Thus, the contract came to be a legal construct, going beyond restitution for performed consideration or reliance, becoming the method of private parties looking after their own interests, making their private law and allocating business risk. In the conception of justice, notions of equality of exchange and a just price gave way to the law setting a framework for each to protect his interests in nominating his terms for the bargain. In the world of Bentham and Smith, the State was not involved in the regulation of parties’ bargains, which bargains vindicated perceived self-interest in a competitive world.
- 124 In this framework, legal positivism developed. Equity became stabilised into a rule-based structure with a reduced role for discretion as to individual cases<sup>121</sup> and law became separated from morality<sup>122</sup>. This model of contract theory underlying the classical law of contract was lucidly discussed by Patrick Atiyah<sup>123</sup> and Grant Gilmore<sup>124</sup> in their great works. It can be described thus. The parties deal with each other at arm’s length, each relying on his own skill and judgment, negotiating with each other over price and terms through offer and counter offer. Neither party owes a duty of disclosure; silence is not binding. Each must study the circumstances and assess all relevant matters, including risk and look to his own counsel, relying on his own judgment. Contract is made upon manifested acceptance of unrevoked offer. Mistake, pressure or other circumstance vitiating freely manifested consent are narrowly construed. The content of the contract is entirely a matter for the parties. Unfairness is an irrelevant concept. In such a model, as Lord Devlin said<sup>125</sup> “free

dealing was fair dealing”. The court’s function did not include assessing fairness.

125 The accommodation of the duty of good faith or fair dealing into this model is a matter of great importance. The extent of the intrusion of the obligation into that theory depends upon the content of the obligation.

126 Given the familiarity of the law with the notion of good faith in the way I have described an intrusion into contract theory of a principle or obligation of the kind discussed by Judge Breitel before McLelland J is not a radical alteration, indeed it is not an intrusion at all. That is, in part, because the classical model did not succeed in driving out all notions of fairness from the law. In particular, essential to the law of contract was the support of the bargain made as expressed by Cockburn CJ, Lord Blackburn and Griffith CJ. A principle or obligation of good faith of the kind discussed by Judge Breitel is a buttressing of the foundational notions of honesty and faithfulness to the bargain that have always existed. The principle is reinforced by the recognition that contractual obligations do not set up a choice or election to perform or pay damages. Contractual promises supported by consideration constitute legal rights to performance.<sup>126</sup>

127 Such an approach can be seen to reflect the approach of the United States Court of Appeals for the District of Columbia Circuit in *Tymshare Inc v Covell*<sup>127</sup> in an opinion written by Judge Scalia (as he then was). There the “excluder analysis” of Professor Summers and Professor Farnsworth’s view that the significance of the doctrine was in implying terms into an agreement was given particular weight. The doctrine of good faith performance was said to be a means of finding within a contract an implied obligation not to engage in the particular form of conduct. Judge Scalia referred to the modern taste to rely on considerations of morality and public policy, rather than achieving objectives, obliquely by honouring the reasonable expectations of the parties created by their autonomous expressions.

- 128 The same notion was expressed by Posner J in *Market Street Associates Ltd Partnership v Frey*<sup>128</sup> in saying the duty of honesty and good faith is not the duty of pre-contractual candour and that it does not require the subordination of self-interest. In an illuminating discourse,<sup>129</sup> Judge Posner rooted the obligation in the agreement of the parties. He emphasised that contracts come in different forms and for different purposes. Some allocate risks in the participation in markets, some are concerned with family or social relationships, some are to regulate future co-operative adventures. He said that the office of good faith was to forbid opportunistic behaviour that would take advantage of the position of the other in a way un contemplated by the bargain and contrary to the substance of the bargain.<sup>130</sup>
- 129 How good faith operates will depend upon context and the evident contractual purposes of the arrangement. In a risk allocation contract, such as a futures contract or a time charter in an operating market, true good faith may well be the punctilious and complete performance of the bargain, to the letter. Whining about how the market has moved in a market which can move may itself be bad faith.
- 130 On the other hand, in a long term, though non-fiduciary, contract, good faith may require give and take, co-operation and a reasonable consideration of the interests of the other. No business person would find this moralistic or paternalistic – as long as it conformed in structure and intent with the bargain.
- 131 To go beyond this and to posit a wider notion detached from the agreement of the parties, conforming with a duty of general candour and fairness, beyond the structure and terms of the contract faces the problems of lack of legitimacy of underpinning theory and, apart from statute, a lack of legal technique or method of creating the duty. It would also raise a wider question in the law of torts about the development of a doctrine of abuse of rights.<sup>131</sup>

- 132 What may not suffer from any vice in judicial method is the open recognition of good faith and fair dealing as a general norm and operative principle which underpins the assessment of the formation (including implication of terms), interpretation and performance of contracts. This would conform with the content and fabric of our existing law (general law and statute), conform with the core elements of the same principles in the laws of many contemporary legal systems, conform with the law merchant for centuries, conform with the contemporary development of the law merchant and standards in international commercial law, conform with the legal theory that underpins the law of contract and conform with the recognition that honesty and reasonable fair dealing are norms of conduct generally assumed to be exhibited by the commercial community in business dealings.
- 133 An analogy (perhaps imperfect) exists in public international law, where good faith stands as a universally recognised principle and an absolutely necessary ingredient in the operation of the international legal order,<sup>132</sup> without necessarily being an independent source of obligation in itself. Its place and role, as an operative principle can be seen as assisting in giving content and legal reach to acts undertaken. The International Court of Justice in *In re Border and Transborder Armed Actions (Nicaragua v Honduras)*<sup>133</sup> said that good faith “is not in itself a source of obligation where none would otherwise exist”.<sup>134</sup>
- 134 This approach, though constrained, expressly recognises the norm as an underlying and operative principle. If this were the position in private law, the formation, interpretation and performance of contract could all be informed by the express norm. Implication of terms would proceed on the basis of the operative working principle of recognised importance and coherence.
- 135 The fundamental change involved (that has been taken in *Renard, Alcatel* and *Hungry Jack’s*) is the recognition of the norm of good faith as an operative working legal principle. As Judge Posner said, it is not

newfangled welfare-state paternalism or a sediment of altruism; rather, it is a principle which has inhered in the fabric of commerce for centuries and which our courts have recognised on a piecemeal basis for a long time.

- 136 Whilst not always adhered to by all courts in the United States, there is a clear limitation in many American cases that good faith is an interpretative tool and an obligation directed to the terms of the contract itself. It assists in interpretation and implication, but it is not a duty independent standing apart from the contract provisions (including implications), or inconsistent with them.<sup>135</sup> Indeed, such is stated in the commentary to the UCC § 1-304.<sup>136</sup>
- 137 To the extent that such an approach is recognised, questions of the inter-related operation of construction and implication, the legal method of implication and the extent of implication necessary in any particular contract will arise. From the existing authorities in New South Wales, it might be said that these questions should be addressed in the framework of the express recognition of the norm or principle of good faith in the sense that I have discussed.
- 138 Even if it be correct that the doctrine in its operation and extent described by Farnsworth, Scalia J, Posner J and the commentary to § 1-304 of the *Restatement (2d) of Contracts* does not add materially to the well-established legal rules that I have earlier described, as Steytler J said in *Central Exchange v Anaconda*, the implication of a term or the use of the recognised norm or obligation would undoubtedly bring a degree of flexibility that is not present in the law. Further, as Sir Anthony Mason said,<sup>137</sup> the recognition of the concept might bring a degree of coherence to the various rules that presently exist.
- 139 At some point, the High Court will be required to consider these and related issues. The Court's response will be of importance to both the theoretical and practical direction of the Australian law of contract.

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- \* President, New South Wales Court of Appeal. I am indebted to my tipstaff Amanda Foong and researcher Anna Garsia for their assistance and discussion in preparing this lecture.
- 1 *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1.
- 2 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234.
- 3 *Hughes Bros Pty Ltd v Trustees of Roman Catholic Church* (1993) 31 NSWLR 91.
- 4 *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349.
- 5 *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187; 69 NSWLR 558.
- 6 *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151; P Finn, "Commerce, The Common Law and Morality" (1990) *Melbourne University Law Review* 87.
- 7 A F Mason, "Contract, Good Faith and Equitable Standards in Fair Dealing" (2000) 116 *Law Quarterly Review* 66.
- 8 *Central Exchange v Anaconda* [2002] WASCA 94; 26 WAR 33.
- 9 *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228; *Wenzel v ASX Ltd* [2002] FCAFC 400; 125 FCR 570 at 586-587.
- 10 [2002] WASCA 94; 26 WAR 33.
- 11 *Royal Botanic Gardens and Domain Trust v South Sydney Council* [2002] HCA 5; 76 ALJR 436 at 445 [40], 452 [88] and 463 [155].
- 12 *United Group Rail Services Ltd v Rail Corporation New South Wales* [2009] NSWCA 177; 74 NSWLR 618.
- 13 *Macquarie International Health Clinic v Sydney South West Area Health Service* [2010] NSWCA 268.
- 14 There are too many scholarly articles on the topic of good faith to cite here, however, particular reference should be made to: Mason, above n 7; R Powell, "Good Faith in Contracts" (1965) 9 *Current Legal Problems* 16; The Hon. Mr Justice Steyn, "The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy" (1991) 6 *Denning Law Journal* 131; T R H Cole, "Law – All in Good Faith" [1994] *Building and Construction Law* 18; H K Lücke, "Good Faith and Contractual Performance" in P D Finn (Ed), *Essays on Contract* (The Law Book Co Ltd 1987) 155-182; R McDougall, "The Implied Duty of Good Faith in Australian Contract Law" (2006) 108 *Australian Construction Law Newsletter* 28; J Stapleton, "Good Faith in Private Law" (1999) 52 *Current Legal Problems* 1; E Peden, *Good Faith in the Performance of Contracts* (LexisNexis Butterworths 2003); P Finn, "Good Faith and Fair Dealing: Australia" (2005) 11(4) *New Zealand Business Law Quarterly* 378; W Tetley, "Good Faith in Contract: Particularly in the Contracts of Arbitration and Chartering" (2004) 35(4) *Journal of Maritime Law and Commerce* 561; C D Gonthier, "Liberty, Equality, Fraternity: The Forgotten Leg of the Trilogy" (2000) 45 *McGill Law Journal* 567; E A Farnsworth, "Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code" (1963) 30 *University of Chicago Law Review* 666; R S Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968) 54(2) *Virginia Law Review* 195; S J Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith" (1980) 94 *Harvard Law Review* 369; S J Burton, "Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code" (1981) 67 *Iowa Law Review* 1; R S Summers, "The General Duty of Good Faith – Its Recognition and Conceptualization" (1982) 67 *Cornell Law Review* 810; M G Bridge, "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?" (1984) 9 *Canadian*

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*Business Law Journal* 385; Finn (1989), above n 6; J F O'Connor, *Good Faith in English Law* (Dartmouth 1990); E A Farnsworth, "Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Conventions and National Laws" (1995) 3 *Tulane Journal of International and Comparative Law* 47; M E Hiscock, "The Keeper of the Flame: Good Faith and Fair Dealing in International Trade" (1996) 29 *Loyola of Los Angeles Law Review* 1059; J Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 *Law Quarterly Review* 433; P Finn, "Internationalisation or Isolation: The Australian Cul de Sac? The Case of Contract Law" (Bond University 20th Anniversary Symposium, 26-27 June 2009).

15 Devlin J writing extra-judicially, "The Relation Between Commercial Law and Commercial Practice" (1951) 14 *Modern Law Review* 249.

16 [1924] AC 226 at 259.

17 B N Cardozo, *The Nature of the Judicial Process* (Yale University Press 1921) at 165.

18 (1761) 2 Burr 1198 at 1214; 97 ER 787 at 795.

19 (1774) 1 Cowp 143 at 153; 98 ER 1012 at 1017.

20 *Federal Commerce and Navigation Co Ltd v Tradax Export SA (The 'Maratha Envoy')* [1978] 1 AC 1.

21 *Ibid* at 7 and 8, where Lord Diplock said:

"... the freight market for chartered vessels still remains a classic example of a free market. It is world-wide in coverage, highly competitive and sensitive to fluctuations in supply and demand. It is a market in which the individual charterers and shipowners are matched in bargaining power and are at liberty to enter into charterparties in whatever contractual terms they please.

...

No market such as a freight, insurance or commodity market, in which dealings involve the parties entering into legal relations of some complexity with one another, can operate efficiently without the use of standard forms of contract and standard clauses to be used in them. Apart from enabling negotiations to be conducted quickly, standard clauses serve two purposes. First, they enable those making use of the market to compare one offer with another to see which is the better; and this, as I have pointed out, involves considering not only the figures for freight, demurrage and dispatch money, but those clauses of the charterparty that deal with the allocation of misfortune risks between charterer and shipowner, particularly those risks which may result in delay. The second purpose served by standard clauses is that they become the subject of exegesis by the courts so that the way in which they will apply to the adventure contemplated by the charter-party will be understood in the same sense by both the parties when they are negotiating its terms and carrying them out.

It is no part of the function of a court of justice to dictate to charterers and shipowners the terms of the contracts into which they ought to enter on the freight market; but it is an important function of a court, and particularly of your Lordships' House, to provide them with legal certainty at the negotiation stage as to what it is that they are agreeing to. and if there is that certainty, then when occasion arises for a court to enforce the contract or to award damages for its breach, the fact that the members of the court themselves may think that one of the parties was unwise in agreeing to assume a particular misfortune risk or unlucky in its proving more expensive to him than he expected, has nothing to do with the merits of the case or with enabling justice to be done. The only

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merits of the case are that parties who have bargained on equal terms in a free market should stick to their agreements. Justice is done by seeing that they do so or compensating the party who has kept his promise for any loss he has sustained by the failure of the other party to keep his.”

22 *Scandinavian Trading Tanker v Flota Petrolera Eucatoriana* (*The Scaptrade*) [1983] 1 QB 529 at 540-541; Lord Diplock’s agreement on appeal is to be found at [1983] 2 AC 694 at 703-704.

23 The debate is famously captured in the essay exchange between H L A Hart and Lon L Fuller, see H L A Hart, “Positivism and the Separation of Law and Morals” (1958) 71 *Harvard Law Review* 593 and in direct response, L L Fuller, “Positivism and Fidelity to Law – A Reply to Professor Hart” (1958) 71 *Harvard Law Review* 630. The debate can also be seen by comparing the key works of the eminent legal theorists of the late 19<sup>th</sup> and 20<sup>th</sup> century, see for example J Austin, *Lectures on Jurisprudence, or The Philosophy of Positive Law* (4th Ed, John Murray 1879) (edited by R Campbell); J Austin, *The Province of Jurisprudence Determined* (John Murray 1832); H Kelsen, “The Pure Theory of Law – Its Method and Fundamental Concepts”, (1934) 50 *Law Quarterly Review* 474; H Kelsen, “The Pure Theory of Law – Part II”, (1935) 51 *Law Quarterly Review* 517; L L Fuller, *The Morality of Law* (Revised Ed, Yale University Press 1969); R Dworkin, *Taking Rights Seriously*, (Duckworth 1977) (containing a reprint of Dworkin’s famous early essays “The Model of Laws I” and “The Model of Laws II”); J Finnis, *Natural Law and Natural Rights* (Clarendon Press 1980); H L A Hart, *The Concept of Law*, (2nd Ed, Clarendon Press 1994); W G Friedmann, *Legal Theory* (5th Ed, Columbia University 1967) Ch 3.

24 249 NY 458 (1928).

25 John 18:38.

26 *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378; *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] 2 AC 164; *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd* [2005] UKPC 37; [2006] 1 WLR 1476; *Westpac New Zealand Limited v MAP and Associates Ltd* [2010] NZCA 404.

27 *Westpac NZ v Map and Associates* [2010] NZCA 404 at [46]:

“[When the bank] has actual knowledge of the circumstances of the transaction ... such as to render its participation contrary to normally acceptable standards of honest conduct ... In assessing whether its participation is contrary to such standards, the concept of the reasonable banker may well prove helpful. In this context, factors such as the significance or unusual nature of the transaction, the customer’s banking practices, banking practices within the relevant industry and statutory reporting requirements will all be relevant.”

28 UCC § 1-201(19).

29 UCC § 1-201(20).

30 *Golden Strait Corporation v Nippon Yusen Kubishika Kaisha (The ‘Golden Victory’)* [2007] UKHL 12; [2007] 2 AC 353.

31 *Transfield Shipping Inc v Mercator Shipping Inc (‘The Achilleas’)* [2008] UKHL 48; [2009] 1 AC 61.

32 (1854) 9 Ex 351; 156 ER 145.

33 *Koufos v C Czarnikow Ltd (‘The Heron II’)* [1969] 1 AC 350.

34 See the *Marine Insurance Act 1909* (Cth), ss 39-47 for the operation of warranties and *Bank of Nova Scotia v Hellenic Mutual War Risk Association (Bermuda) Ltd (The ‘Good Luck’)* [1992] 1 AC 233 at 262-264.

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35 *Marine Insurance Act*, ss 52 and 53.

36 *Marine Insurance Act*, s 54.

37 *Marine Insurance Act*, s 54.

38 *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; 156 CLR 41.

39 *Ibid* at 70 and 72-73 (Gibbs CJ), 96-97 (Mason J); *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* [2010] HCA 19; 84 ALJR 446.

40 Lücke, above n 14 at 155; E A Farnsworth, "Good Faith in Contract Performance" in J Beatson & D Friedmann (Eds), *Good Faith and Fault in Contract Law* (Clarendon, 1997) at 155.

41 *Restatement (2d) of Contracts*; E A Farnsworth, *Farnsworth on Contracts* (3rd Ed, Aspen 2004).

42 See for example *Bush v Marshall* 47 US 284 at 291 (1848) on appeal from a District Court in the Territory of Iowa: "contrary to good faith and fair dealing, he has interfered to overbid his vendor ... [he] ought in justice and equity to pay for it the full consideration"; *Railroad Company v Howard* 74 US 392 (1868) on appeal from the Circuit Court of Iowa; *Marsh v Masterson* 101 NY 401 at 410-411 (1886) in the Court of Appeals of New York; *Uhrig v Williamsburgh City Fire Insurance Co* 101 NY 362 (1886) in the Court of Appeals of New York.

43 74 US 392 at 413 (1868).

44 *Market Street Associates Ltd Partnership v Frey* 941 F2d 588 at 595 (7<sup>th</sup> Cir 1991).

45 Summers (1968), above n 14.

46 Comment d.

47 Burton (1980), above n 14.

48 Farnsworth (1963) above n 14; Farnsworth (2004), above n 41.

49 (1864) 5 B & S 840 at 852; 122 ER 1043 at 1047.

50 (1880-81) LR 6 App Cas 251 at 263.

51 (1896) 7 QLJ 68 at 70-71.

52 [1931] HCA 21; 45 CLR 359 at 378.

53 [1979] HCA 51; 144 CLR 596.

54 *Ibid* at 607-608.

55 [1932] All ER Rep 494 at 507.

56 [2010] NSWCA 268.

57 *Ibid* at [147].

58 [1982] 2 NSWLR 766.

59 [1993] FCA 445; 117 ALR 393 at 402-403.

60 "wie Treu und Glauben" (literal translation: fidelity and faith).

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- 61 R Zimmerman & S Whittaker (Eds), *Good Faith in European Contract Law* (Cambridge University Press 2000) at 21.
- 62 A member of the Executive or an administrator must exercise power in good faith, requiring an honest and genuine attendance to the power being exercised. This carries with it the need to act honestly and genuinely for the purposes of the power. The extent to which this carries an element of reasonableness may be debateable. Reasonableness (in the sense of in accordance with reason) may be seen to be a separate requirement, though its place as a necessary element of the exercise of public power is not finally established. Fairness is the central operative consideration of the rules of procedural fairness or natural justice. Here the exercise of the power is conditioned by the largely non-self interested context. The power has a public object.
- 63 Notions of good faith infuse equity whether in a fiduciary context or generally, such as in the law of mortgages, penalties, unconscionability, clean hands or unconscionability and many other areas. It takes its place in the remedial structure of orders for specific performance and injunctions.
- 64 Good faith is a central notion in the law of property. It is at the heart of priorities in the place of the bona fide purchaser for value without notice.
- 65 In company law directors are obliged to act in good faith and in the interests of the company as a whole. This is a fiduciary context, even though, in many practical circumstances, directors and those to whom they answer have an interest. That interest is to be subordinated to the beneficiary, the company as a whole.
- 66 [1982] HCA 52; 149 CLR 571.
- 67 (1863) 3 B & S 364 at 371-372; 122 ER 138 at 141.
- 68 [1953] HCA 31; 89 CLR 527.
- 69 [1972] HCA 36; 128 CLR 529.
- 70 Ibid at 538.
- 71 Ibid at 543.
- 72 Ibid at 547.
- 73 Ibid at 549-555. One of the cases discussed by Stephen J in *Godfrey Constructions* was *Gardiner v Orchard* [1910] HCA 18; 10 CLR 722, where Isaacs J in discussing such clauses that gave the vendor the power to rescind said that three considerations attended them: first, the purpose of the clause which was as stated by Sir John Romilly in *Greaves v Wilson* (1858) 25 Beav 290 at 293; 53 ER 647 at 650 to be the case where the vendor was to be put to so much expense and trouble as to make it unreasonable that he be called upon to do it; secondly, the bona fides on the part of the vendor in using the power; and thirdly, the reasonableness of the use of the clause.
- 74 [1973] HCA 13; 130 CLR 575. See also what Viscount Radcliffe said in *Selkirk v Romar Investments Ltd* [1963] 1 WLR 1415 at 1422-1423 in discussing equitable principles to control such a clause:

“[the vendor] “must not act arbitrarily, or capriciously, or unreasonably. Much less can he act in bad faith. He may not use the power of rescission to get out of the sale ‘brevi manu’, since by doing so he makes a nullity of the whole elaborate and protracted transaction. Above all, perhaps, he must not be guilty of “recklessness’ in entering into his contract .. [being] an unacceptable indifference to the situation of a purchaser who is allowed to enter into a contract with the expectation of obtaining a title which the vendor has no reasonable anticipation of being able to deliver.”

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75 *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433 at 439.

76 *New Zealand Shipping Co Ltd v AM Satterthwaite & Co Ltd* [1975] AC 154 at 167.

77 [2004] UKHL 55; [2005] 2 AC 1 at 50-53; [59]-[64].

78 See eg, *Civil Procedure Act 2005* (NSW), s 27; *Fair Work Act 2009* (Cth), s 228.

79 The Hon A M Gleeson AC, “Individualised Justice – The Holy Grail” (1995) 69 *Australian Law Journal* 421.

80 [2009] NSWCA 177.

81 [2010] NSWCA 268.

82 *Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd* [1968] HCA 8; 118 CLR 429 at 436-437; *The ‘Eurymedon’* [1975] AC 154 at 167; and *Meehan v Jones* (1982) 149 CLR 571 at 589.

83 For reference to the literature on *lex mercatoria*, see N van Houtte, *The Law of International Trade* (Sweet & Maxwell 2002) at 24-28; M Pryles, “Application of the *Lex Mercatoria* in International Arbitration” (2004) 78 *Australian Law Journal* 396; and G Petrochilos, *Procedural Law in International Arbitration* (Oxford 2004) at 36 [2.04] fnnt 79.

84 As to international private law, see generally R Goode et al, *Transnational Commercial Law: International Instruments and Commentary* (Oxford 2004); International Institute for the Unification of Private Law, *UNIDROIT Principles of International Commercial Contracts 2004* (Rome, 2004), produced by a group of international scholars and practitioners under the direction of Prof Joachim Bonell (Part I of which was published in 1994); Commission on European Contract Law, *Principles of European Contract Law* (Part I of which was published in 1995, Part II in 1999 and Part III in 2003), prepared by scholars from all member states of the European Community.

85 *UNCITRAL Model Law on Electronic Commerce* (1996), adopted by the UN General Assembly on 16 December 1996 (Report of the 6<sup>th</sup> Committee A/51/628) and *UNCITRAL Model Law on Electronic Signatures* (2001), adopted by the UN General Assembly on 12 December 2001 (Report of the 6<sup>th</sup> Committee A/56/588); Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (“Directive on Electronic Commerce”) and Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures; Comité Maritime International, *Rules for Electronic Bills of Lading*, 1990; the BOLERO (Bill of Lading Electronic Registration Organization) bill of lading, prepared through the co-operation of the TT Club (Through Transport Mutual Insurance Association Ltd) and SWIFT (Society for Worldwide Interbank Financial Transactions) operating as a joint venture company which was commercially launched on 27 September 1999; *ICC Uniform Customs and Practice for Documentary Credits UCP 500* (ICC Publication No 500, 1993) and the supplement to UCP 500 for Electronic Presentation (eUCP) as to electronic presentation of documents.

86 *United Nations Convention on Contracts for the International Sale of Goods* (Vienna, 11 April 1980) UN Doc. No. A/CONF 97/19 (“CISG”), which superseded the *Convention relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods* (The Hague, 1 July 1964) and the *Convention relating to a Uniform Law on the International Sale of Goods* (The Hague, 1 July 1964); and the *ICC Official Rules for the Interpretation of Trade Terms* (Incoterms 2000), replacing earlier versions.

87 First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making

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such safeguards equivalent throughout the Community; Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents; *Convention on Agency in the International Sale of Goods* (Geneva, 17 February 1983); and *UNIDROIT Model Franchise Disclosure Law* (Rome, September 2002).

88 *UNCITRAL Model Law on International Credit Transfers*, adopted by UNCITRAL on 15 May 1992; UCP500 and eUCP, above n 85; *ICC Uniform Rules for Demand Guarantees* (ICC Publication No 458, 1992); *International Standby Practices ISP98* (ICC Publication No 590, 1998) by the Institute of International Banking Law & Practice Inc; *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (New York, opened for signature 11 December 1995, entered into force 1 January 2000); *ICC Uniform Rules for Contract Bonds* (ICC Publication No 524, 1993).

89 European Bank for Reconstruction and Development, *Model Law on Secured Transactions* (1994); The Organization of American States' *Model Inter-American Law on Secured Transactions* (2002); the various maritime conventions dealing with security: *International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages* (Brussels, 10 April 1926); *International Convention on Maritime Liens and Mortgages* (Geneva, 6 May 1993); *International Convention Relating to the Arrest of Sea-Going Ships* (Brussels, 10 May 1952); *International Convention on the Arrest of Ships* (Geneva, 12 March 1999); *Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft* (Rome, 29 May 1933); *Convention on the International Recognition of Rights in Aircraft* (Geneva, 19 June 1948) ("Geneva Convention"); *UNIDROIT Convention on International Financial Leasing* (Ottawa, 20 May 1988); *Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment* (Cape Town, 16 November 2001) ("Capetown Convention and Aircraft Protocol"); *UNIDROIT Convention on International Factoring* (Ottawa, 28 May 1988); *United Nations Convention on the Assignment of Receivables in International Trade* (New York, 12 December 2001).

90 *UNCITRAL Model Law on Cross-Border Insolvency* (1997), adopted by the UN General Assembly on 15 December 1997 (Report of the 6<sup>th</sup> Committee A/52/649); *European Union Convention on Insolvency Proceedings* (Brussels, 23 November 1995); and Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings.

91 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems; and Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

92 *Convention on the Law Applicable to Agency* (The Hague, 14 March 1978); *Convention on the Law Applicable to Contracts for the International Sale of Goods* (The Hague, 22 December 1986); *Convention on the Law Applicable to Contractual Obligations* (Rome, 19 June 1980) ("Rome Convention"); *Inter-American Convention on the Law Applicable to International Contracts* (Mexico, 17 March 1994); and *Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (The Hague, 13 December 2002).

93 *European Convention on State Immunity* (Basel, 16 May 1972); Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("Brussels I"); *Protocol on International Jurisdiction in Contractual Matters* (Buenos Aires, 5 August 1944) ("Buenos Aires Protocol"), a protocol to the Southern Common Market (MERCOSUR) Agreement or *Treaty of Asunción* (Asuncion, 26 March 1991); *Convention on the Service Abroad of Judicial or Extra-judicial documents in Civil or Commercial Matters* (The Hague, 15 November 1965); the Council Regulation (EC) No 1348/2000 of 29 May 2000 on the service in the Member States of judicial and extrajudicial documents in civil or commercial matters; *Convention on the Taking of Evidence Abroad in Civil or Commercial Matters* (The Hague, 18 November 1970); Council Regulation (EC) No 1206/2001 of 28 May 2001 on the cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters; and the American Law Institute and UNIDROIT jointly developed *Principles of Transnational Civil Procedure* (2004).

94 *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (New York, 10 June 1958) adopted in 1958 by the UN Conference on International Commercial Arbitration at its 24<sup>th</sup> meeting (“*New York Convention*”); *Inter-American Convention on International Commercial Arbitration* (Panama City, 30 January 1975); *UNCITRAL Model Law on International Commercial Arbitration* (1985); *UNCITRAL Arbitration Rules* (1976); *ICC Rules of Arbitration* (1998); *London Court of International Arbitration Rules* (1998).

95 L Trakman, *The Law Merchant: The Evolution of Commercial Law* (Fred B Rothman & Co 1983).

96 M J Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts* (3rd Ed, Transnational Publishers, Inc 2005) at 127 ff.

97 Ibid at 128.

98 Ibid at 139. In *United Group Rail* [2009] NSWCA 177, the Court of Appeal upheld the contractual certainty of an express clause providing for good faith negotiations to resolve a dispute. What was required was an honest and genuine attempt to settle the dispute with attendance and fidelity or faithfulness to the bargain and the rights and duties it had created.

99 See eg, *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407. Articles 4.1-4.3 are as follows:

**“Article 4.1** (*Intention of the parties*)

1. A contract shall be interpreted according to the common intention of the parties.
2. If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

**Article 4.2** (*Interpretation of statements and other conduct*)

1. The statements and other conduct of a party shall be interpreted according to that party’s intention if the other party knew or could not have been unaware of that intention.
2. If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

**Article 4.3** (*Relevant circumstances*)

In applying Articles 4.1 and 4.2, regard shall be had to all the circumstances, including

- (a) preliminary negotiations between the parties;
- (b) practices which the parties have established between themselves;
- (c) the conduct of the parties subsequent to the conclusion of the contract;
- (d) the nature and purpose of the contract;
- (e) the meaning commonly given to terms and expressions in the trade concerned;
- (f) usages.”

100 **Article 4.4** (*Reference to contract or statement as a whole*)

Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear.

**Article 4.5** (*All terms to be given effect*)

Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.

**Article 4.6** (*Contra proferentem rule*)

If contract terms supplied by one party are unclear, an interpretation against that party is preferred.

**Article 4.7** (*Linguistic discrepancies*)

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Where a contract is drawn up in two or more language versions which are equally authoritative there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up.”

101

“**Article 4.8** (*Supplying an omitted term*)

1. Where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied.
2. In determining what is an appropriate term regard shall be had, among other factors, to
  - (a) the intention of the parties;
  - (b) the nature and purpose of the contract;
  - (c) good faith and fair dealing;
  - (d) reasonableness.

...

**Article 5.1.2** (*Implied obligations*)

Implied obligations stem from

- (a) the nature and purpose of the contract;
- (b) practices established between the parties and usages;
- (c) good faith and fair dealing;
- (d) reasonableness.”

102

Art 5.1.8 deals with reasonable notice for termination of a long term contract; Art 7.1.7, force majeure; Art 7.2.2, performance of non-monetary obligations; and Art 7.4.8, mitigation of harm.

103

*Sale of Goods (Vienna Convention) Act 1986* (NSW); *Sale of Goods (Vienna Convention) Act 1986* (WA); *Sale of Goods (Vienna Convention) Act 1986* (SA); *Sale of Goods (Vienna Convention) Act 1986* (Qld); *Sale of Goods (Vienna Convention) Act 1987* (VIC); *Sale of Goods (Vienna Convention) Act 1986* (TAS); *Sale of Goods (Vienna Convention) Act 1986* (ACT); *Sale of Goods (Vienna Convention) Act* (NT).

104

For a discussion of the compromise involved, see R Goode, H Kronke & E McKendrick, *Transnational Commercial Law: Text, Cases and Materials* (Oxford University Press 2007) at 278; and Bonell, above n 96. For a similar interpretation clause, see Art 4 in the *Convention on International Factoring*.

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Bonell, above n 96; Farnsworth in Beatson & Friedmann (1997), above n 40.

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See the comments of Mason J in *State Government Insurance Commission v Trigwell* [1979] HCA 40; 142 CLR 617 at 633.

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[1957] HCA 81; 100 CLR 277.

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[2008] HCA 2; 233 CLR 542.

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See eg, *Giannarelli v Wraith* [1988] HCA 52; 165 CLR 543 at 584-585; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* [1988] HCA 44; 165 CLR 107 at 160-162; *Mabo v Queensland (No 2)* [1992] HCA 23; 175 CLR 1 at 29-30 and 57-58; *Dietrich v R* [1992] HCA 57; 177 CLR 292 at 318-320.

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*Renard* (1992) 26 NSWLR 234; *Alcatel* (1998) 44 NSWLR 349; *Hughes Bros* (1993) 31 NSWLR 91; and *Hungry Jack's* (2001) 69 NSWLR 558.

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*Coal Cliff Collieries* (1991) 24 NSWLR 1.

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*United Group Rail* [2009] NSWCA 177.

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(1992) 26 NSWLR 234 at 261-263.

- 114 See eg, *Hawkins v Clayton* [1988] HCA 15; 64 CLR 539 at 573 (Deane J) ; *Byrne v Australian Airlines Ltd* [1995] HCA 24; 185 CLR 410 at 422 (Brennan CJ, Dawson and Toohey JJ) and 442 (McHugh and Gummow JJ); *Breen v Williams* [1996] HCA 57; 186 CLR 71 at 90-91 (Dawson and Toohey JJ) and 123-124 (Gummow J); *Moneywood Pty Ltd v Salamon Nominees Pty Ltd* [2001] HCA 2; 202 CLR 351 at 374 [80] (Gummow J); *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liq)* [2000] HCA 25; 202 CLR 588 at 610 [46] (Gaudron, McHugh, Gummow and Hayne JJ).
- 115 See Peden, *Good Faith in the Performance of Contracts* (2003), above n 14, Ch 2.
- 116 P Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford University Press 1979); J Gordley, *The Philosophical Origins of Modern Contract Doctrine* (Clarendon 1991); R Harrison, *Good Faith in Sales* (Sweet & Maxwell 1997) Chs 1-2.
- 117 See J Austin, *The Province of Jurisprudence Determined and Lectures on Jurisprudence*, above n 23.
- 118 Atiyah, above n 116.
- 119 (1766) 3 Burr 1905 at 1910; 97 ER 1162 at 1165.
- 120 *Carlsh v Salt* [1996] 1 Ch 335; *Beyfus v Lodge* [1925] Ch 350 at 357; P N Wikrama-Nayake, *Voumard: The Sale of Land in Victoria* (4th Ed, Law Book Co 1986) at 216 ff.
- 121 R Meagher, J D Heydon & M Leeming, *Meagher, Gummow & Lehane's Equity Doctrines and Remedies* (4th Ed, LexisNexis Butterworths 2002) at 8 [1-070].
- 122 For a review of the separation of law and morality in the theories of Jeremy Bentham and John Austin and the position of legal positivism in the 20<sup>th</sup> century see: Hart (1958), above n 23. More generally see: Austin (1879), above n 23; Kelsen (1934), above n 23; Kelsen (1935), above n 23; Hart (1994), above n 23; and Friedmann, above n 23, Chs 21-27.
- 123 Atiyah, above n 116 at 402-403.
- 124 G Gilmore, *The Death of Contract* (Ohio State University Press 1976).
- 125 P Devlin, *The Enforcement of Morals* (Oxford University Press 1965) at 47.
- 126 *Ahmed Angullia bin Hadjee Mohammed Salleh Angullia v Estate and Trust Agencies (1927) Ltd* [1938] AC 624 at 634-635 and *Coulls v Bagot's Executor and Trustee Company Ltd* [1967] HCA 3; 119 CLR 460 at 504; *Alley v Deschamps* (1806) 13 Ves Jr 225 at 227 and 228; 33 ER 278 at 279; and *United Group Rail* [2009] NSWCA 177 at [72].
- 127 727 F2d 1145 (1984).
- 128 941 F2d 588 (7<sup>th</sup> Cir 1991).
- 129 Ibid at 594-596.
- 130 Ibid at 595.
- 131 H C Gutteridge, "Abuse of Rights" (1933-35) 5 *The Cambridge Law Journal* 22; D J Devine, "Some Comparative Aspects of the Doctrine of Abuse of Rights" [1964] *Acta Juridica* 148; J H Crabb, "The French Concept of Abuse of Rights" (1964) 6(1) *Inter-American Law Review* 1; P Catala & J A Weir, "Delict and Torts: A Study in Parallel" (1964) 38(2) *Tulane Law Review* 221; A Mayrand, "Abuse of Rights in France and Quebec" (1974) 34 *Louisiana Law Review* 993; J Cueto-Rua, "Abuse of Rights" (1975) 35 *Louisiana Law Review* 965; V Bolgar, "Abuse of Rights in France, Germany and Switzerland: A Survey of a Recent Chapter in Legal Doctrine" (1975) 35 *Louisiana Law Review* 1015; G M Redmann, "Abuse of Rights: An Overview of the Historical

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Revolution and the Current Application in Louisiana Contracts” (1987) 32 *Loyola Law Review* 946; J M Perillo, “Abuse of Rights: A Pervasive Legal Concept” (1995) 27 *Pacific Law Journal* 37; A Gambaro, “Abuse of Rights in Civil Law Tradition” (1995) 4 *European Review of Private Law* 561; E Reid, “Abuse of Rights in Scots Law” (1998) 2 *Edinburgh Law Review* 129.

<sup>132</sup> Article 2(2) of the *Charter of the United Nations* and Arts 26 and 31(1) of the *Vienna Convention on the Law of Treaties*; Permanent Court of Arbitration, *Venezuelan Preferential Claims Case* (22 February 1904) in J B Scott (Ed), *Hague Court Reports* (1910) Vol 1 at 55; the *Nuclear Tests Case (Australia v France)* [1974] ICJ Rep 253 at 268; and see generally E Zoller, *Good Faith in Public International Law* (Paris 1977), discussed by M Virally in a review essay in (1983) 77 *American Journal of International Law* 130; B Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Cambridge Grotius Publications Ltd 1987) Pt 2 at 105-160.

<sup>133</sup> [1988] ICJ Rep 69 at 105 [94].

<sup>134</sup> This was reiterated in *In re Land and Maritime Boundary (Cameroon v Nigeria)* [1998] ICJ Rep 275 at 297 [39]; see generally the discussion in *The Roma Case* [2005] 2 AC 1 at 52 [62].

<sup>135</sup> *Duquesne Light Co v Westinghouse Elec Co* 66 F3d 604 at 617 (3<sup>rd</sup> Cir 1995); *Riggs National Bank of Washington v Linch* 36 F3d 370 at 373 (4<sup>th</sup> Cir 1994).

<sup>136</sup> Commentary introduced in 1994 says the following in relation to § 1-304: “This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached”.

<sup>137</sup> Mason, above n 7 at 94.