

Some Reflections on Good Faith in Contract Law

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Good faith is a topic that has been written about at inordinate length, by an almost intolerably wide group of people – some worth reading, some not. I gave a paper at the University of New England in New South Wales in October 2010 on this subject. In preparation for it I collected enough material to fill a closely typed footnote of 2½ pages.

It is also a topic, at least in Australia, that many view as one which gives an insight into the personality and politics of a person: if in favour of good faith, the person must be left of centre, a do-gooder, a liberal progressive, woolly thinking and lacking intellectual rigour; if against, *und so weiter*. I am not sure why good faith should conjure such unmanly characteristics (if you will excuse the sexism in the aid of metaphorical effect). After all, no one could accuse Judge Posner of the 7th Circuit or Justice Scalia of the Supreme Court of woolly thinking and lack of intellectual rigour, let alone of being unmanly do-gooders.

In 1984, in *Tymshare Inc v Covell*,¹ then Judge Scalia of the District of Columbia Circuit perhaps put his finger on one of the aspects of good faith that has deflected attention from its place in contract law and filled people with a fear of indeterminate content. The so-called “modern doctrine” of the “obligation to perform in good faith” was, he said, “simply a rechristening of fundamental principles of contract law well established ...”. After referring approvingly to Professor Summers’ notion of an excluder analysis (excluding bad faith), he agreed with Professor Alan Farnsworth that the significance of the doctrine is in “implying terms in the agreement”. Scalia J went on:

“When these two insights are combined, it becomes clear that the doctrine of good faith performance is a means of finding

¹ 727 F 2d 1145 (1984).

within a contract an implied obligation not to engage in the particular form of conduct which, in the case at hand, constitutes 'bad faith.' In other words, the authorities that invoke, with increasing frequency, an all-purpose doctrine of 'good faith' are usually if not invariably performing the same function executed (with more elegance and precision) by Judge Cardozo in *Wood v Lucy, Lady Duff-Gordon*, 222 NY 88, 91, 118 NE 214, 214 (1917), when he found that an agreement which did not recite a particular duty was nonetheless "instinct with [...] an obligation," imperfectly expressed,' quoting from *McCall Co v Wright*, 133 AD 62, 68, 117 NYS 775, 779 (1909), aff'd, 198 NY 143, 91 NE 516 (1910). The new formulation may have more appeal to modern taste since it purports to rely directly upon considerations of morality and public policy, rather than achieving those objectives obliquely, by honouring the reasonable expectations created by the autonomous expressions of the contracting parties. But it seems to us that the result is, or should be, the same."

The point he was making was that expressing the obligation generally in terms of moral duty implies a source of authority and content from outside the contract. This Scalia J rejects. So did Posner J in *Market Street Associates Limited Partnership v Frey*.² If I may respectfully say, this is a hugely rewarding judgment to read for any contract lawyer in the common law tradition. Posner J first warned against the morally directed content of the phrase confusing contractual obligation with fiduciary obligation. Secondly, he rejected that the duty supported a freestanding obligation of precontractual candour or disclosure. Thirdly, he noted that after formation the party is not required to be an altruist and loosen obligations when the other gets into trouble; but he did distinguish this from sharp practice by taking deliberate advantage of an oversight by the other about its rights. This is akin to theft and if it be permitted by the law, the production of over elaborate contracts will be necessitated. Once the contract is made the situation changes and a modicum of trust, co-operation and honesty is required – but (and this is what is essential to grasp) *in furtherance of the bargain*.

Judge Posner rooted the obligation in the agreement of the parties. He emphasised that contracts come in different forms and for different purposes.

² 941 F 2d 588 (1991).

Some allocate risks in the participation in markets, some are concerned with family or social relationships, some are to regulate future co-operative ventures. 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; thus, inferentially, to support the bargain as properly construed.

He said memorably at 595:

“The contractual duty of good faith is thus not some newfangled bit of welfare-state paternalism or (*pace* Duncan Kennedy, ‘Form and Substance in Private Law Adjudication,’ 89 *Harv L Rev* 1685, 1721 (1976)) the sediment of an altruistic strain in contract law, and we are therefore not surprised to find the essentials of the modern doctrine well established in nineteenth-century cases...”.

These views of Scalia J and Posner J may not represent the uniform United States application of the doctrine. The individual and separate existence of State law, and the non-existence of federal (at least non-maritime) common law since *Erie Railway Co v Tompkins*,³ makes search for a uniform position in the United States elusive, notwithstanding attempts at uniformity. Some sense of uniformity is brought by the two great modern attempts to unify and synthesise American law – The Uniform Commercial Code (UCC) and the Restatements of various branches of the law, including contracts. The UCC has been adopted with minor variations in almost every state.

That the UCC is widely adopted does not mean that it is uniformly interpreted. Uniform expression of principle often belies different approaches to evaluative application. This is a phenomenon well-known to those trying to prove foreign law as a fact and is not limited to different evaluations and practical applications of good faith.

Before turning to some more local considerations, let me reinforce the approach of Judges Scalia and Posner by reference to the UCC itself, the

³ 304 US 64 (1938).

Restatement (2d) of Contracts and to a circuit decision administering Pennsylvania law.

The original UCC defined good faith as “honesty in fact in the conduct or transactions concerned” [1-201 (19)]. This was later revised to “honesty in fact and the observance of reasonable commercial standards of fair dealing” [1-201 (20)]. Similar wording appears in different parts of the UCC: eg sale of goods [2-103 (1)(b)] and negotiable instruments [3-103 (a)(4)]. The Restatement (2d) [205] reads: “Every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement.” Baldly stated thus, it has an appearance of a freestanding distinct obligation capable of being sued on, and thus there is the necessity to give it meaningful content.

At this point what Judges Scalia and Posner said becomes critical. The implication is referable to the particular agreement of the parties, its place being in the interpretation, construction and implication of what has been agreed, by reference to an assumption that the parties have agreed to conduct themselves fairly towards each other in support of their mutual bargain.

It is here that the 1994 commentary on the UCC by the Permanent Editorial Board should be noted. It stated that the good faith provision “does not support an independent cause of action for failure to perform or enforce in good faith ... [T]he 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.”

In *Duquesne Light Co v Westinghouse Electric Corp*,⁴ the Third Circuit, dealing with Pennsylvania law, expressed the matter similarly. Quoting Professor Steven Burton, it said:

⁴ 66 F 3d 604 at 617 (1995).

“With rare exception, the courts use the UCC good faith requirements in aid and furtherance of the parties’ agreement, not to override the parties’ agreement for reasons of fairness, policy, or morality.”

The Court continued (citing Burton):

“[The] courts generally utilize the good faith duty as an interpretive tool to determine ‘the parties’ justifiable expectations’, and do not enforce an independent duty divorced from the specific clauses of the contract.”

Of course, the devil may lie in the words “with rare exception” and “generally”.

Let me turn away from the United States for a moment to some considerations of a general character that require some consideration and reflection in connection with good faith.

First, as I have already said, identical linguistic expressions of principle can be applied very differently by courts in different countries. That is a reflection of the different influences and expectations of different societies upon the development of legal doctrine and how it is applied. One need not be an adherent of sociological jurisprudence to accept this.

Secondly, great care must always be exhibited to prevent the particular factual application of a general principle being wrongly transformed into a narrower legal rule. This process causes confusion and multiplicity of so-called rules, all needing to be reconciled through factual analysis, with resultant confusion of doctrine.

Thirdly, there is the deep importance to the community, in particular the commercial community, of 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. The two features of doctrine and practice play on each other: legal doctrine will be influenced by the question whether it undermines or promotes reasonably efficient dispute resolution. Further, the

conflict or choice as to how to express law is often seen to be between apparently value-free rules and more generally expressed evaluative norms, principles or concepts.

A striking example of the relationship between expression of principle and method of dispute resolution is the law of salvage. Salvage reward is just that – a reward, not a quantum meruit, arrived at in a discretionary evaluation. That works, without overly long and detailed evidence or incoherently inconsistent results, only by the use of skilled, experienced and specialised arbitrators or maritime judges.

Commercial law is, or to a significant degree should be, the reflection of society's facilitation, not hindrance,⁵ 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 they are 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 *Cantiere San Rocco SA v Clyde Shipbuilding and Engineering Co*,⁶ 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.

Involved in the above reconciliations of doctrine and practice, and of rule and principle, are what can be seen as competing considerations of certainty and generally expressed norms of conduct. It is to be recognised at the outset that no system of law and no system of commercial law can exist without

⁵ Lord Justice Devlin, "The Relation between Commercial Law and Commercial Practice" (1951) 14 Mod LR 249.

⁶ [1924] AC 226 at 259.

generally expressed norms of conduct. Also, sometimes, a sensible rule can only be expressed coherently, and with any degree of certainty, using a generally expressed norm.

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 a given problem. In such a system, practical certainty is said to be achieved by the clarity of the value-free rule and its application to relevant facts, without the need for theoretical generalisation or morals. That this is a pervading view is hardly surprising, since it reflects what occurs in many instances of adjudication.⁷ It is, however, inadequate to explain fully the process of decision-making or to express fully and clearly legal principle.

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, thereby aiding the operation of markets. Reduction of the risk attending a transaction reduces transactional cost and tends to a lowering of price. This can increase total economic activity.

But certainty is not necessarily value-free. There have been few equals of Lord Mansfield in his understanding, and lucid expression, of commercial law. In 1761, in *Hamilton v Mendes*,⁸ 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.”

⁷ Benjamin N Cardozo, *The Nature of the Judicial Process* (Yale University Press, 1921) at 165.

⁸ (1761) 2 Burr 1198 at 1214; 97 ER 787 at 795.

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*,⁹ 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.”

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.

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.

Whilst certainty undoubtedly contributes to the reduction of risk and the more efficient working of markets, 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 tolerated aggressive sharp practice) is a risk factor likely to outweigh the benefit of clarity of rules.

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.¹⁰ It is also an intensely

⁹ (1774) 1 Cowp 143 at 153; 98 ER 1012 at 1017.

¹⁰ 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

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 be struck between specific rule-based certainty and the application of generalised norms informed by honesty, reasonable expectations and fairness.

Take honesty. It 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*¹¹ comparing acceptable conduct in the workaday world of the market with the fiduciary's "punctilio of an honor the most sensitive" 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.)

Honesty is a concept wide enough to include, but not to 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

late nineteenth and the twentieth 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*, Rev 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 Press, 1967), Ch 3.

¹¹ 249 NY 458 (1928).

others: the “normally acceptable standards of honest conduct”,¹² 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.

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 in *Westpac New Zealand Ltd v MAP & Associates Ltd*¹³ recently answered the question by reference to whether the customer’s conduct reflected “normally acceptable standards of honest conduct.”¹⁴ More precise definition of “acceptable” in this context in furtherance of rule-based certainty would be futile and only likely to elevate factual applications of the legal norm into narrower and more intricate rules, producing incoherence in fine distinctions.

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

¹² *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.

¹³ [2010] NZCA 404.

¹⁴ *Westpac New Zealand Ltd v MAP & Associates Ltd* [2010] NZCA 404 at [46]:

“[A] bank will be liable for dishonest assistance where it 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 be relevant.”

exemplifications of factual applications as rules, and create detail and confusion. 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.

The recognition of the importance of honesty takes us some way down the path of discussing good faith. Good faith includes honesty.

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.

There are many examples in commercial law of mechanical or value-free rules giving way to a norm or principle (beyond the implicit requirement of honesty) that is more evaluative in foundation, whether because that is the chosen compromise or because the generally expressed norm best expresses a simple rule. One recent and one older example in commercial law illustrate the point.

In *The 'Achilleas'*¹⁵ 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*¹⁶ and *Koufos v Czarnikow*¹⁷ and to approach the calculation of damages in contract by

¹⁵ [2009] 1 AC 61.

¹⁶ (1854) 9 Ex 351; 156 ER 145.

¹⁷ *Koufos v C Czarnikow Ltd ('The Heron II')* [1969] 1 AC 350.

reference to more general notions of reasonable conformance with the substance of the underlying bargain. His Lordship, 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.

In marine insurance, the notion of discharge of the insurer from liability is central to the operation of the promissory warranty¹⁸ and to the operation of the principles of deviation¹⁹ and delay.²⁰ 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".²¹ The rule, easily learned and easily retained, is expressed in general terms.

The above 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.

Let me now return to good faith. The reality is that good faith or cognate notions, perhaps differently expressed on occasions, infuse the general law (using that expression to encompass common law, equity and maritime law).

¹⁸ 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.

¹⁹ *Marine Insurance Act 1909* (Cth), ss 52 and 53.

²⁰ *Marine Insurance Act 1909* (Cth), s 54.

²¹ *Marine Insurance Act 1909* (Cth), s 54.

Time and space permit only a present concentration on the law concerning contracts. It is apt, however, to recognise that the expression “good faith” is embedded in public law,²² equity and trusts,²³ property²⁴ and company law,²⁵ taking its meaning and legal content in those areas from context and the incidents of relationships governed by law and equity.

What I wish to say, however, should be understood as being quite distinct from the use of good faith in the fiduciary context. 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.²⁶ 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 in order to act solely in the interests of the beneficiary. This subordination will be derived from the degree of power and control and consequent vulnerability of the respective parties in the relationship, and from the essential element of service or representation of the interests of the other.

²² 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 debatable. 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.

²³ Notions of good faith infuse equity whether in a fiduciary context or generally, such as in the law of mortgages, penalties, unconscionability, clean hands and many other areas. It takes its place in the remedial structure of orders for specific performance and injunctions.

²⁴ 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.

²⁵ 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.

²⁶ *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; 156 CLR 41.

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 arm's 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 bargain²⁷ and fair dealing.²⁸

The first example of what is embedded in the law is the implied term requiring the fidelity to the bargain.

In 1864, in *Stirling v Maitland*, Cockburn CJ said:²⁹

“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.”

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:³⁰

“[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.”

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

²⁷ H K Lücke, “Good Faith and Contractual Performance” in P D Finn (ed), *Essays on Contract* (Law Book Co, 1987), 155-182 at 155; E A Farnsworth, “Good Faith in Contract Performance” in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (Clarendon Press, 1997) at 155.

²⁸ *Restatement (2d) of Contracts*; E A Farnsworth, *Farnsworth on Contracts*, 3rd ed (Aspen, 2004).

²⁹ (1864) 5 B & S 840 at 852; 122 ER 1043 at 1047.

³⁰ (1880-81) LR 6 App Cas 251 at 263.

Justice Griffith in *Butt v M'Donald*.³¹ He stated a general rule of somewhat broader reach than that stated either 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.”

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*.³² that contained within every express promise is a negative covenant not to hinder or prevent the fulfilment of the purpose of the express covenant.

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*.³³ After referring to *Mackay v Dick* and *Butt v M'Donald*, Mason J discussed the implication of a contractual duty to co-operate. He said³⁴ 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 the 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

³¹ (1896) 7 QLJ 68 at 70-71.

³² [1931] HCA 21; 45 CLR 359 at 378.

³³ [1979] HCA 51; 144 CLR 596.

³⁴ *Ibid* at 607-608.

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.”

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.

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.

This may perhaps be seen to be 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*,³⁵ the legal implication of what is reasonable runs throughout the whole of English law and is easily made.

There is also a body of case law in contract that deals 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 having their source in contract by implications of honesty, reasonableness and good faith. Examples are numerous.

³⁵ [1932] All ER 494 at 507.

In *Meehan v Jones*,³⁶ all the members of the High Court implied an obligation to act honestly in a clause providing a party with 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.

In *Stadhard v Lee*,³⁷ 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”.

In *Carr v JA Berriman Pty Ltd*,³⁸ 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.

In *Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd*,³⁹ the High Court dealt with cl 14 of the then standard form contract for the sale of land: the clause providing 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 CJ⁴⁰ 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 upon his willingness to perform. Walsh J⁴¹ recognised that the cases prevented the power being used arbitrarily or unreasonably. Gibbs J⁴² constrained the clause by the need to act reasonably. Stephen J⁴³ employed

³⁶ [1982] HCA 52; 149 CLR 571.

³⁷ (1863) 3 B & S 364 at 371-372; 122 ER 138 at 141.

³⁸ [1953] HCA 31; 89 CLR 327.

³⁹ [1972] HCA 36; 128 CLR 529.

⁴⁰ *Ibid* at 538.

⁴¹ *Ibid* at 543.

⁴² *Ibid* at 547.

⁴³ *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

notions of proper purpose and reasonableness. See also *Pierce Bell Sales Pty Ltd v Frazer*.⁴⁴

In *Interfoto Library Ltd v Stiletto Ltd*,⁴⁵ 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.

Lord Wilberforce made a similar comment in *The 'Eurymedon'*⁴⁶ 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')*.⁴⁷

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 MR 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.

⁴⁴ [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."

⁴⁵ *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433 at 439.

⁴⁶ *New Zealand Shipping Co Ltd v AM Satterthwaite & Co Ltd* [1975] AC 154 at 167.

⁴⁷ [2004] UKHL 55; [2005] 2 AC 1 at 50-53 [59]-[64].

There is no doubt, however, that our law, including the law of contract, is littered with principles, rules and approaches which contain 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.

Let me turn to good faith as a coherent implication or underpinning norm. The most frequently posited difficulty is that of giving the phrase content. The posited principle of "playing fair" implies a non-contractual source at work. This is not necessarily the case.

In a search for the meaning which American courts have given the phrase, I have examined some of the cases in New York (a great commercial centre, no little brother to London, but historically a jurisdiction in which English law has influenced doctrine). They repay reading. What they reveal is a coherent utilisation of good faith as an informing implication or assumption that assists in the construction of contracts and the implication of terms to give effect to the perceived honest and reasonable expectations of the parties in respect of the bargain made and its limits. None would surprise an English lawyer; the process of implication may be somewhat readier than that reflected in English cases, but the legal reasoning and results do not suggest any source of obligation outside the contract.

Let me give you some examples.

In 1868, in *Railroad Company v Howard*, Justice Clifford, giving the opinion of the US Supreme Court, said:⁴⁸

"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".

⁴⁸ 74 US 392 at 413 (1868).

The expression of the matter thus reflects a reach of the concept intrinsically tied to, and constrained by, the contract entered and 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. It echoed Cockburn CJ, Lord Blackburn and Griffith CJ.

In *Uhrig v Williamsburg City Fire Insurance Company*,⁴⁹ the New York Court of Appeals dealt with an arbitration clause in an insurance policy. Both the insured and insurer were to appoint an appraiser, the two appraisers appointing an umpire. The two appraisers could not agree. There was evidence that the insurer, resisting an endeavour to break the deadlock over the appointment of an umpire, refused to appoint another appraiser. Earl J said:

“Under the arbitration clause it was the duty of each party to act in good faith to accomplish the appraisal in the way provided in the policy...”.

Good faith was the informing consideration requiring the promotion and not the defeat of the bargain by taking steps not expressly called for in the words of the contract.

There are numerous New York cases constraining the party given a contractual power in the way I have described in English and Australian cases; it was said that good faith required such powers and satisfactions to be reached otherwise than arbitrarily, capriciously, irrationally or dishonestly. It was sometimes expressed as not construing a contract to leave one party at the mercy of the other: *Doll v Noble*;⁵⁰ *Industrial and General Trust Co Ltd v Tod*.⁵¹

⁴⁹ 56 Sickels 362; 4 NE 745 (1886).

⁵⁰ 116 NY 230; 22 NE 406 (1889) (NYCA).

⁵¹ 180 NY 215; 73 NE 7 (1905) (NYCA).

*New York Central Iron Works v United States Radiator Co*⁵² is a good example of the use of good faith to give content to promises. The case concerned a supply and distribution contract. The vendor agreed to supply goods and the buyer agreed to deal exclusively in the vendor's goods and to develop and enlarge the market. Both were merchants in trade and not speculators. The vendor refused to supply goods beyond a certain number based on historic demand and sought a limit by implication by reference to past years' sales. The Court refused but also said this:⁵³

“But we do not mean to assert that the plaintiff had the right ... to order goods to any amount. Both parties ... are bound to carry it out in a reasonable way. The obligation of good faith and fair dealing towards each other is implied in every contract of this character. The plaintiff could not use the contract for the purpose of speculation in a rising market since that would be a plain abuse of the rights conferred.... [A breach would be shown by pleading that] orders were [made] in excess of the plaintiff's reasonable needs and were not justified by the conditions of the business or the customs of the trade. In other words, that the plaintiff was not acting reasonably or in good faith, but using the contract for a purpose not within the contemplation of the parties; that is to say, for speculative as distinguished from regular and ordinary business purposes.”

Reasonableness was identified with good faith. Good faith demanded that the contract not be employed beyond its business purposes: compare *The 'Achilleas'*.

*Patterson v Meyerhofer*⁵⁴ concerned an agreement to sell land from the plaintiff to the defendant. At the time of agreement the defendant knew that the plaintiff was not then the owner, but expected to obtain the land at a foreclosure sale. The defendant went to auction and outbid the plaintiff. She got the land at a price better than she had agreed to pay the plaintiff. Willard Bartlett J said:⁵⁵

⁵² 174 NY 331; 66 NE 967 (1903) (NYCA).

⁵³ 174 NY 331 at 335-6; 66 NE 967 at 968.

⁵⁴ 204 NY 96; 97 NE 472 (1912).

⁵⁵ 204 NY 96 at 100-101; 97 NE 472 at 473.

“In the case of every contract there is an implied undertaking on the part of each party that he will not intentionally and purposely do anything to prevent the other party from carrying out the agreement on his part. This proposition necessarily follows from the general rule that a party who causes or sanctions the breach of an agreement is thereby precluded from recovering damages for its non-performance or from interposing it as a defense to an action upon the contract ... ‘Where a party stipulates that another shall do a certain thing, he thereby impliedly promises that he will himself do nothing which may hinder or obstruct that other in doing that thing.’ ...

By entering into the contract to purchase from the plaintiff property which she knew he would have to buy at the foreclosure sale in order to convey it to her, the defendant impliedly agreed that she would do nothing to prevent him from acquiring the property at such sale.”

Good faith supported a construction of the contract that gave the bargained-for commercial benefit to the party.

Similarly in *Simon v Etgen*,⁵⁶ where a promise to sell land and use the profit as the payment under a release contained an implication to sell within a reasonable time. The implication of good faith is not made generally as a free standing term but as an informing implication to shape the precise content of the particular implication. It is an operative norm.

The expression “every contract implies good faith and fair dealing” often used in these early cases directs attention to what flows from the entry into the relationship – a standard of conduct, in the context of the bargain, that is manifested in the construction of and giving content to the contract in accordance with honesty and the reasonable expectations of those in the bargain. That language directs attention to a norm, not the implication in every contract of a free standing obligation.

Let me finish this dipping into New York law by reference to one further case, *Kirke La Shelle Co v Armstrong*.⁵⁷ The parties settled a dispute about the assignment by a debtor of certain plays and property. As consideration for

⁵⁶ 213 NY 589; 107 NE 1066 (1915) (NYCA).

⁵⁷ 263 NY 79; 188 NE 163 (1933) (NYCA).

the settlement, the defendant promised to pay the plaintiff half of all moneys received from the revivals of the plays in New York and elsewhere and to obtain the plaintiff's consent to all contracts effecting the exploitation of the play. The defendant, without consulting the plaintiff, sold the "talkie" rights to the play, arguing that this new medium unknown at the time of contract fell outside its terms. The New York Court of Appeals disagreed with the trial court and the appellate division and found a fiduciary relationship. That need not concern us. It also founded its decision on contract, aside from any fiduciary relationship. The Court expressed the principle in a way that equated good faith and fair dealing with support of the bargain entered, in the sense of the grant of the construed benefit in commercial terms:

"in every contract there is an implied covenant that neither party shall do anything which will have the affect of destroying or injuring the right of the other to receive the fruits of the contract, which means that in every case there exists an implied covenant of good faith and fair dealing."

Following two cases, *Harper Bros v Klaw*⁵⁸ and *Manners v Morosco*,⁵⁹ the Court held that even though the agreement did not cover "talkies", the unrestricted deployment of those rights would (on the evidence) destroy the value of the play. There was an implied negative covenant not to use the ungranted part of the copyright estate to the detriment of the particular rights granted. The "talkie" rights had to be the subject of agreement.

One can agree or not with the implication. There were cases that refused to go so far. What is clear, though, is that good faith was being used to support and give reasonable protection to the willed bargain of the parties and the commercial benefits it provided – not as an externally sourced obligation to be fair outside the contractual terms.

Turning briefly to the content of the phrase when used expressly by parties in the context of an obligation to negotiate in good faith, in *United Group Rail*

⁵⁸ 232 F 609 (1916) (NY District Court).

⁵⁹ 252 US 317 (1920).

Services v Rail Corporation of NSW,⁶⁰ the New South Wales Court of Appeal held that an obligation to negotiate was a sufficiently certain concept for a definite contractual obligation. The Court expressly disagreed with *Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd*⁶¹ and *Walford v Miles*.⁶² In discussing the practical content of the phrase in the context of the obligation to negotiate a resolution of a dispute under an existing contract, the Court said.⁶³

“It is to be anticipated at the time of entry into the contract that disputes and differences that may arise will be anchored to a finite body of rights and obligations capable of ascertainment and resolution by the chosen arbitral process (or, indeed, if the parties choose, by the Court). The negotiations (being the course of treaty or discussion) with a view to resolving the dispute will be anticipated not to be open-ended about a myriad of commercial interests to be bargained for from a self-interested perspective (as in *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd*).⁶⁴ Rather, they will be anticipated to involve or comprise a discussion of rights, entitlements and obligations said by the parties to arise from a finite and fixed legal framework about acts or omissions that will be said to have happened or not happened. The aim of the negotiations will be anticipated to be to resolve a dispute about an existing bargain and its performance. Honest and genuine differences of opinion may attend the parties’ views of their rights and obligations. Such things as difficulties of proof and uncertainty as to fact or law may, perfectly legitimately, strike the parties differently. That accepted, honest business people who approach a dispute about an existing contract will often be able to settle it. This requires an honest and genuine attempt to resolve differences by discussion and, if thought to be reasonable and appropriate, by compromise, in the context of showing a faithfulness and fidelity to the existing bargain....

The parties have mutually agreed to bring an approach of genuineness and good faith to that process of seeking resolution of any such disagreement. That agreement carried with it, in ordinary language, a requirement to bring an honestly held and genuine belief about their mutual rights and obligations and about the controversy to the negotiations, and to negotiate by reference to such beliefs.

⁶⁰ [2009] NSWCA 177; 74 NSWLR 618.

⁶¹ [1975] 1 WLR 297.

⁶² [1992] 2 AC 128.

⁶³ [2009] NSWCA 177; 74 NSWLR 618 at [70]-[74].

⁶⁴ (1991) 24 NSWLR 1.

These are not empty obligations; nor do they represent empty rhetoric. An honest and genuine approach to settling a contractual dispute, giving fidelity to the existing bargain, does constrain a party. The constraint arises from the bargain the parties have willingly entered into. It requires the honest and genuine assessment of rights and obligations and it requires that a party negotiate by reference to such. A party, for instance, may well not be entitled to threaten a future breach of contract in order to bargain for a lower settlement sum than it genuinely recognises as due. That would not, in all likelihood reflect a fidelity to the bargain. A party would not be entitled to pretend to negotiate, having decided not to settle what is recognised to be a good claim, in order to drive the other party into an expensive arbitration that it believes the other party cannot afford. If a party recognises, without qualification, that a claim or some material part of it is due, fidelity to the bargain may well require its payment. That, however, is only to say that a party should perform what it knows, without qualification, to be its obligations under a contract. Nothing in cl 35.11 prevents a party, not under such a clear appreciation of its position, from vindicating its position by self-interested discussion as long as it is proceeding by reference to an honest and genuine assessment of its rights and obligations....

If business people are prepared in the exercise of their commercial judgement to constrain themselves by reference to express words that are broad and general, but which have sensible and ascribable meaning, the task of the Court is to give effect to, and not to impede, such solemn express contractual provisions. It may well be that it will be difficult, in any given case, to conclude that a party has not undertaken an honest and genuine attempt to settle a dispute exhibiting a fidelity to the existing bargain. In other cases, however, such a conclusion might be blindingly obvious. Uncertainty of proof, however, does not mean that this is not a real obligation with real content.”

In this analysis it is vital to distinguish both questions of incompleteness and questions of certainty.

Recently, in *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service*,⁶⁵ Hodgson JA, in dealing with the content of the phrase “utmost good faith” in express terms in the subject contracts (which were to last for 100 years), adopted what Sir Anthony Mason had said in a paper in 2000, namely that a contractual obligation of good faith embraced the following notions:

⁶⁵ [2010] NSWCA 268.

- (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 other cases in the New South Wales Court of Appeal, in particular *Alcatel Australia Ltd v Scarcella*⁶⁶ and *Burger King Corporation v Hungry Jack's Pty Ltd*.⁶⁷ His Honour, however, recognised that:⁶⁸

“ ... 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”.

The usual content of the obligation of good faith that can be extracted from existing New South Wales Court of Appeal cases 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; and
- (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.

⁶⁶ [2001] NSWCA 401.

⁶⁷ [2001] NSWCA 187; 69 NSWLR 558.

⁶⁸ [2010] NSWCA 268 at [147].

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.

In *United States Surgical Corp v Hospital Products International Pty Ltd* at first instance,⁶⁹ McLelland J (as he then was) examined New York law and accepted the evidence of Judge Breitel (formerly Chief Judge of the New York Court of Appeals) 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*.

Gummow J in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd*⁷⁰ 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.

The phrase good faith is, of course, 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 an obligation so to act – even if it goes beyond, or is inconsistent with, the agreed terms of the parties' contract. That, however, is not how New York contract law sees the matter.

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

⁶⁹ [1982] 2 NSWLR 766.

⁷⁰ [1993] FCA 445; 117 ALR 393 at 402-403.

expression of good faith,⁷¹ 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. These decisions are said to have hit the German legal community like a bombshell.

At this wider level, the obligation, if it exists, may require general pre-contractual disclosure to a degree which requires that 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.

The legitimacy of, and any acceptance of, such a broader imposed norm depends upon the theoretical framework from which one works. It is at this point that one needs to consider some of the theoretical underpinnings of a law of contracts.

Legal technique

Common law courts do not legislate, nor are they law reform agencies.⁷² 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. In *Attorney-General (Cth) v Alinta Ltd*,⁷³ Gleeson CJ made clear that legal method was not the propounding of a mechanical application of inflexible rules, without regard to wisdom and expediency. The common law, Gleeson CJ said, was judge-made:⁷⁴

“ ... 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.”

⁷¹ “wie Treu und Glauben” (literal translation: fidelity and faith).

⁷² See the comments of Mason J in *State Government Insurance Commission v Trigwell* [1979] HCA 40; 142 CLR 617 at 633.

⁷³ [2008] HCA 2; 233 CLR 542.

⁷⁴ *Ibid* at [5].

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.⁷⁵

It is not a large step to recognise the conception of good faith 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.

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 of necessity in this context by Priestley JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*⁷⁶ reveals the circularity that can attend rejection of an implication of good faith because of the need to show necessity for business efficacy.

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

⁷⁵ 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.

⁷⁶ (1992) 26 NSWLR 234 at 261-263.

comprehensive document.⁷⁷ It would inform a ready implication in many contracts of an appropriately constructed obligation.

Debates continue about method and mechanism.⁷⁸ 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

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

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.

For instance, the view that a 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.

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 requires more than formal manifestation and, to be “true”,

⁷⁷ 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).

⁷⁸ See E Peden, *Good Faith in the Performance of Contracts* (LexisNexis Butterworths, 2003), Ch 2.

consent requires 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 involves not only symmetry of information, but also a just price. If such matters were included in the theory underpinning contract, they would reflect essential or immanent characteristics of the contract as an institution or end informing its essence or being.

The above elements can be seen underlying pre-nineteenth century natural law theory derived from Aristotle and Aquinas, revived in sixteenth and seventeenth century Spain and taken up by the northern European natural law theorists, including Grotius, Pufendorf and Pothier.⁷⁹

These became problematic notions with the rise of individual responsibility, competition and the 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 influenced by the legal positivism of John Austin.⁸⁰

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.⁸¹

⁷⁹ P Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford University Press, 1979); J Gordley, *The Philosophical Origins of Modern Contract Doctrine* (Clarendon Press, 1991); R Harrison, *Good Faith in Sales* (Sweet & Maxwell, 1997) Chs 1-2.

⁸⁰ See J Austin, *The Province of Jurisprudence Determined and Lectures on Jurisprudence*, above n 10.

⁸¹ Atiyah, above n 80.

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 those promises, the notion of a just price or an equal exchange becomes problematic.

Lord Mansfield expressed the view in *Carter v Boehm*⁸² 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 ...”.

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.⁸³

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 this framework, legal positivism developed; equity became stabilised into a rule-based structure with a reduced role for discretion as to individual cases,⁸⁴ and law became, to a degree, perceived to be separated from morality.⁸⁵ This

⁸² (1766) 3 Burr 1905 at 1910; 97 ER 1162 at 1165.

⁸³ *Carlish v Salt* [1906] 1 Ch 335; *Beyfus v Lodge* [1925] Ch 350 at 357; P N Wikrama-Nayake and L Voumard, *The Sale of Land in Victoria*, 4th ed (Law Book Co, 1986) at 216ff.

⁸⁴ R Meagher, J D Heydon and M Leeming, *Meagher, Gummow & Lehane’s Equity Doctrines and Remedies*, 4th ed (LexisNexis Butterworths, 2002) at 8 [1-070].

⁸⁵ 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 twentieth century, see: Hart (1958), above n 10. More generally see: Austin (1879), above n 10; Kelsen

model of contract theory underlying the classical law of contract was lucidly discussed by Patrick Atiyah⁸⁶ and Grant Gilmore⁸⁷ in their great works. The extent to which unfairness became an irrelevant concept is important. In such a model, as Lord Devlin said,⁸⁸ “free dealing was fair dealing”. The court’s function did not include assessing fairness. The expression of the court’s refusal to mend bad bargains was commonplace. Yet in the United States, as has been seen, the courts never abandoned expressions of good faith and fair dealing within the contract.

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 and maintained since the nineteenth century in the United States is not a radical alteration; indeed, it is not an intrusion at all. Never driven out was the recognition that 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 and the New York cases, and in the views of Judges Posner and Scalia, 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 fault-free choice or election to perform or pay damages. Contractual promises supported by consideration constitute legal rights to performance.⁸⁹

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

(1934), above n 10; Kelsen (1935), above n 10; Hart (1994), above n 10; and Friedmann, above n 10, Chs 21-27.

⁸⁶ Atiyah, above n 80 at 402-403.

⁸⁷ G Gilmore, *The Death of Contract* (Ohio State University Press, 1976).

⁸⁸ P Devlin, *The Enforcement of Morals* (Oxford University Press, 1965) at 47.

⁸⁹ *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].

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.

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.

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 the 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.⁹⁰

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,⁹¹ without

⁹⁰ 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 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.

⁹¹ 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, *La Bonne Foi en Droit International Public (Good Faith in Public International Law)* (Editions A Pedone, 1977), discussed by M Virally in a review essay in (1983) 77 *American Journal of International Law* 130; B Cheng,

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)*⁹² said that good faith “is not in itself a source of obligation where none would otherwise exist”.⁹³

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 a 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.

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.

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 independently standing apart from the contract provisions (including implications), or inconsistent with them.⁹⁴ Indeed, such is stated in the commentary to the UCC § 1-304.⁹⁵

General Principles of Law as applied by International Courts and Tribunals (Grotius Publications, 1987) Pt 2 at 105-160.

⁹² [1988] ICJ Rep 69 at 105 [94].

⁹³ 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].

⁹⁴ *Duquesne Light Co v Westinghouse Elec Co* 66 F 3d 604 at 617 (1995); *Riggs National Bank of Washington v Lynch* 36 F 3d 370 at 373 (1994).

⁹⁵ 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

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.

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 UCC does not add materially to the well-established legal rules that I have earlier described, as Steytler J said in *Central Exchange Ltd v Anaconda Nickel Ltd*,⁹⁶ the implication of a term or the use of the recognised norm or obligation would undoubtedly bring a degree of flexibility to the operation of the law, in particular implication of terms. Further, as Sir Anthony Mason said,⁹⁷ the recognition of the concept might bring a degree of coherence to the various rules that presently exist.

Finally, you will recall that the court in *Duquesne* used the words “with rare exceptions” and “generally”. There are instances when courts in the US have given the phrase “good faith” from the UCC a scope and content beyond mere implication. Many of these are in franchise cases where the courts have been astute to protect parties (franchisees) with significantly lesser bargaining power.

The existence of these and of some continental notions of an obligation outside the contract make far more acute the cries of “what is its content?” The answer will lie in what is fair dealing in all the circumstances by reference to the court’s perception of the fairness of the exchange. I do not propose to explore this. Neither England nor Australia has a statutory source of such obligation. However, it is not necessarily to be feared as something akin to

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”.

⁹⁶ [2002] WASCA 94; 26 WAR 33.

⁹⁷ A F Mason, “Contract, Good Faith and Equitable Standards in Fair Dealing” (2000) 116 *Law Quarterly Review* 66 at 94.

the expropriation of the means of production by the dictatorship of the proletariat. In Australia a coherent and predictable body of jurisprudence has developed around the simply expressed obligation in trade and commerce not to engage in conduct that is misleading or deceptive or likely to mislead or deceive. Likewise, in New South Wales a similarly coherent body of cases has developed around the *Contracts Review Act 1980*, which authorises the court to vary or set aside non-business contracts that are “unjust”.

Thank you for the invitation to speak and your gracious attention.