Can Arbitrators Make Sense of the Duty of "Good Faith" in Contracts?

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There is considerable confusion in the Courts and in Arbitrations as to what is meant by "Good Faith" in contracts or the contractual "Duty of Good Faith".

Professor Carter and Dr Peden in a recent article[2] state that the confusion in this area of the law is contributed to by two starting points:

1 Is "Good Faith" an independent concept or as Carter and Peden state something inherent in all contracts and
2 What is the content of the "Good Faith" requirement? Is it honesty alone (favoured by Carter and Peden) or does it include a positive obligation to act "reasonably"?

Carter and Peden state that "honesty" includes:

1 not acting arbitrarily or capriciously;
2 not acting with an intention to cause harm; and
3 acting with due respect for the intent of the bargain as a matter of substance not form.

What is "good faith" depends on the circumstances. Depending on the term in the contract under consideration "Good Faith" may include:

1 acting for a proper purpose;
2 consistency of conduct;
3 communication of decisions;
4 co-operation with the other party; or
5 consideration of the interests of the other party.

Definition of Good Faith

In the United States in the Uniform Commercial Code promulgated in 1951, ss 1-201 "good faith" was defined as meaning "*honesty in fact in the conduct of transaction concerned*". This definition has an inhibiting effect on the obligation of good faith as stated in 1-203 as: "*Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.*" In addition, Judges used the term "good faith" vaguely and as an 'excluder'; that is, it "has no general meaning of its own, but … serves to exclude many heterogeneous forms of bad faith" (at 196). In 1968, R.R. Summers stated that the term "good faith" had become used flexibly by Judges so as "*to do justice and do it according to law*". Summers' views were influential in the *Restatement of the Law (Second) of Contracts* adopted in 1979 but published in 1981 by the American Law Institute. In ss 205 of the *Restatement (Second)* it states:

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2 "Good Faith in Australian Contract Law" (2003) 19 JCL 155 (Carter and Peden)

"*Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.*" The recognition of an obligation of good faith in contracts similar to that in the United States and Canada was supported by Priestley JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 at 268.

How an Arbitrator should approach interpreting a Contract

Some judicial guidance on how an Arbitrator should interpret a contract is found in *Pindan Pty Ltd v Uniseal Pty Ltd* [2003] WASC 168 where McKechnie J stated that on questions of law:

1 the arbitrator should first determine in respect of each contract what were the terms and conditions, express or implied, which are incorporated into the contract;
2 in respect of each claim, does the evidence establish there was a breach of any term of the contract;
3 if so, what term and which party was in breach;
4 if there was a breach, did the breach cause loss to the other party?

McKechnie J recognised that the last question may not be able to be answered until the quantum of the loss is resolved.

Ways of Interpreting the Terms of the Contract

Some recent cases rely on the implication of a term of good faith. Carter and Peden caution against this approach. Their advice is that when construing or interpreting the terms in a contract Arbitrators may be on surer ground if they adopt a "commercial construction", that is, one that focuses on the giving effect to the intention of the parties. If this approach is adopted then recourse to the need to imply a term of good faith into the contract will not be needed.

In *Meehan v Jones* (1982) 149 CLR 57 at 529, Mason J stated that "the court should be astute to adopt a construction which will preserve the validity of the contract."

In *Pan Foods Company Importers & Distributors Pty Ltd v Australia and New Zealand Banking Group Ltd* (2000) 74 ALJ 791, Kirby J stated at 794:

> *"Commercial documents… should be construed practically, so as to give effect to their presumed commercial purposes and so as not to defeat the achievement of such purposes by an excessively narrow and artificially restricted construction."*

(see also *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579

Use of Surrounding Circumstances as an aid to interpretation

In the United Kingdom the law has changed in regard to the use of surrounding circumstances as an aid to interpretation of contracts and agreements. In *Investment Compensation Scheme v West Bromidge Building Society* [1998] 1 WLR 896, Lord Hoffmann stated at 912-13 :

"1 Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract;

2 The background was famously referred to by Lord Wilberforce as the "matrix of fact" but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

3 The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear."

In *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251, Lord Hoffmann at 269, clarified his use of the words "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man" as meaning anything which a reasonable man would have regarded as relevant. His Lordship was not encouraging a trawl through "background" which could not have made a reasonable person think that the parties must have departed from conventional usage.

In Australia, the use of the surrounding circumstances as an aid to the interpretation of contracts was referred to by Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337 at 352 (Codelfa) where he stated:

> *"The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning. Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding circumstances as an aid to construction, unless they were known to both parties, although as we have seen, if the facts are notorious knowledge of them will be presumed.*
>
> *It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. The extent to which they have this tendency they are admissible. But in so far they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable. The point is that such statements and actions reveal the terms of the contract which the parties intend or hoped to make. They are superseded by, and merged in, the contract itself. The object of the parol evidence rule is to exclude them, the prior oral agreement of the parties being admissible in aid of construction, though not admissible in an action for rectification."*

In *Manufacturers' Mutual Insurance Ltd v Withers* (1988) ANZ Insurance Cases 60-853 at 75, 343, McHugh JA, said:

> *"However, few, if any, English words are unambiguous or not susceptible of more than one meaning or have a plain meaning. Until a word, phrase or sentence is understood in the light of the surrounding circumstances it is rarely possible to know what it means. In my view evidence of surrounding circumstances would generally be admissible if it is known to both parties or sufficiently notorious to be presumed to be within their knowledge."*

In *Acorn Consolidated Pty Ltd v Hawkslade Investments Pty Ltd* (1999) 21 WAR 425, 436 Owen J stated:

> *"If extrinsic evidence of the surrounding circumstances is admitted, it can be used only for an objective assessment of what a reasonable person armed with the knowledge that the parties actually had, would have understood the words to mean."*

The High Court in the *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 76 ALJR 436 continued to follow Codelfa. The result is that in Australia but not in the United Kingdom the requirement of the concept of ambiguity is necessary to be shown before a Court or an Arbitrator looks at the surrounding circumstances.[3]

In *Brambles Holdings Ltd v Bathurst City Council* (2001) 53 NSWLR 153, 163-4, Heydon JA said that there were three relevant principles of law in this area:

> *"The first relevant principle of law is that pre-contractual conduct is only admissible on questions of construction if the contract is ambiguous and if the pre-contractual conduct casts light on the genesis of the contract, its objective aim, or the meaning of any descriptive term… .*
>
> *The second relevant principle is that post-contractual conduct is admissible on the question of whether a contract was formed….*
>
> *The third relevant principle is that post-contractual conduct is not admissible on the question of what a contract means as distinct from the question of whether it was formed. … ."*

Duty to Co-operate:

Courts have long implied a duty of fairness and co-operation into contractual relations. In *Mackay v Dick* (1881) 6 App Cas 251 at 263, Lord Blackburn stated:

> *"As a general rule, … where in a written contract it appears that both 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. "*

3 see: JW Carter and A Shaw, "*Interpretation, Good Faith and the True Meaning of Contracts: The Royal Botanic Decision*." (2002) 18 JCL 182,186.

Lord Blackburn was not seeking to imply a term of co-operation into the contract but merely restating the duty of fairness and co-operation into the contract.

Good Faith in every Contract

Good faith has always been a requirement of contracts. Carter and Peden state that good faith is the essence of every contract. In many Australian cases the requirement of good faith is assumed by the Court to be implicit in the contact. In *Carr v J.A. Berryman Pty Ltd* (1953) 89 CLR 327 at 347, no reference was made to good faith or to the implication of "an implied term" of Good Faith into the Contract. In that case in a Contract between a "the proprietor" of certain land and a Builder, Clause 1 of the Contract stated:

> *"The Architect may in his absolute discretion and from time to time issue … written instructions or written directions … in regard to the … omission … of any work… . The Builder shall forthwith comply with the Architect's Instructions."*

The issue that arose was : Can the Architect authorise particular items of work contained in the contract with the builder to be carried out not by the builder with whom the contract was made, but by some other builder or contractor?

> *"The Clause is a common and useful clause, the obvious purpose of which – so far as it is relevant to the present case – is to enable the Architect to direct additions to, or substitutions in, or omissions from, the building as planned, which may turn out, in his opinion, to be desirable in the course of the performance of the contract. The words quoted from it would authorise the architect (doubtless within certain limits, …) to direct that particular items of work included in the plans and specifications shall not be carried out. But, they do not, in my opinion, authorize him to say that particular items so included shall be carried out not by the builder with whom the contract is made but by some other builder or contractor. The words used do not, in their natural meaning, extend so far, and a power in the architect to hand over at will any part of the contract to another contractor would be a most unreasonable power, which very clear words would be required to confer." (Fullagar J in Carr v J.A. Berryman Pty Ltd (1953) 89 CLR 327 at 347).*

In *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* [1999] WASC 1046 (16 April 1999) Templeman J considered the issue of the issue of "good faith" in regard to a mining contract termed a "partnering contract." Under this contractual arrangement Thiess agreed to carry out mining operations based genuine estimates of its costs plus an agreed profit margin of 5%. In its defence to a claim for wrongful termination of the contract Placer contended that Thiess had acted in bad faith in relation to the Granny Smith contract with the result that Placer had been overcharged.

Clause B1.1.5 required:

> *"B1.1.5 The successful operation of the contract required Thiess and Placer to act in good faith in all matters relating both the carrying out [of] the works, derivation of the rates and interpretation of this document."*

Templeman J stated:

> *"These provisions are typical of many contained in Section B which do not define rights and obligations with any precision. Their implementation clearly requires goodwill and co-operation on the part of both bodies. "Good Faith" must include those matters.*
> *In addition, I think that the obligation of good faith requires the parties to deal honestly with each other…. That being so, good faith, I think would require Thiess to formulate plant rates which were honestly based on the relevant historical data."*

Templeman J construed

> *"the obligation of good faith as requiring paries to act honestly with each other and to take reasonable steps to co-operate in relation to matters where the contract does not define rights and obligations or provide mechanisms for the resolution of disputes. This would include rate reviews…*
> *In relation to the interpretation of the contract, the obligation of good faith is more difficult to define. I think it requires the parties to construe or give effect to general provisions in such a way as to promote the contractual objectives, which are to be gleaned either from the contract as a whole or from the provision in particular."*

In regard to the termination of the contract Thiess contended that Placer acted in bad faith, unreasonably or in breach of a fiduciary duty in terminating the contract. Templeman J found that Placer had an absolute right to terminate the contract for whatever reason it thought fit. This right was not qualified by good faith considerations. Placer's exercise of its contractual rights involved no breach of contract. Thiess' claim was dismissed.

The issue of good faith was not the subject of appeal either to the Full Court of the Supreme Court of Western Australia or the High Court (see (2003) 196 ALR 257). The issues before the Full Court and the High Court involved the question of damages and their quantification. For further details about this series of cases see: Rachelle Wellard, *"Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd"* (2003) 22(2) The Arbitator and Mediator 99.

Implied Term

In recent years there has been a trend for Courts to imply a term of "good faith" into a contract. The criteria that must be satisfied before a term will be implied in order to give business efficacy to a contract were set out in *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 180 CLR 266:

1. it must be reasonable and equitable;
2. it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
3. it must be so obvious that 'it goes without saying';
4. it must be capable of clear expression; [and]
5. it must not contradict a clear term of the contract.

The Courts are slow to imply a term particularly where the agreement is detailed and comprehensive (see: *Codelfa*). The Courts are willing to imply terms where the parties have evinced a clear intention to enter into legal relations but have expressed their agreement in a form that is too uncertain to be enforced.[4]

Recent cases have implied a requirement of "good faith" into contracts even though no fiduciary relationship was present.[5]

In *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 (*Renard*) at 266, Priestley JA stated:

> *"People generally, including judges and other lawyers, from all strands of the community, have grown used to the courts applying standards of fairness which are consistent with the existence in all contracts of a duty of good faith and fair dealing in performance. In these days anything less is contrary to prevailing community expectations."*

Renard was concerned with an Arbitration between a Principal and a Contractor. Reference was made to Subclause 44.1 that allowed the Principal to call upon the contractor by a notice in writing, to "show cause within a period specified in the notice" why the powers in Clause 44.1 should not be exercised. Clause 44.1 stated:

> ***"44.1 Procedure on Default of Contractor***
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> *If the Contractor defaults in the performance or observance of any covenant, condition or stipulation in the Contract or refuses or neglects to comply with any direction as defined in clause 23 but being one which either the Principal or the Superintendent is empowered to give, make, issue or serve under the Contract and which is issued or given to or served or made upon the Contractor by the Principal in writing or by the Superintendent in accordance with clause 23, the Principal may suspend payment under the Contract and may call upon the Contractor, by notice in writing, to show cause within a period specified in the notice why the powers hereinafter contained in this clause should not be exercised.*
>
> *The notice in writing shall state that it is a notice under the provisions of this clause and shall specify the default, refusal or neglect on the part of the Contractor on which it is based.*

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4 *(Secured Income Real Estate (Aust) Ltd v St. Martins Investments Pty Ltd* (1979) 144 CLR 596 and *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41.)

5 see: *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 (Renard); *Hughes Bros Pty Ltd v Trustees of Roman Catholic Church (Archdiocese of Sydney)* (1993) 31 NSWLR 91, Kirby P and Priestley JA applied Renard; *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1 per Finn J; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* [1999] FCA 903 per Finkelstein J and *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 per Sheller JA with whom Powell and Beazley JA concurred; see also Cheshire and Fifeoot's *Law of Contract*, Eighth Australian Edition, LexisNexis Butterworths, 2002 at para [10.43]; see also Finn P "*Equity and Commercial Contracts: A Comment* (2001) AMPLA Yearbook 414; cf Carter and Peden, *"Good Faith in Australian Contract Law"* (2003) 19 JCL155 at fn. 4 ; and C.F.E. Rickett, *"Some Reflections on Open-Textured Commercial Contracting"* (2001) AMPLA Yearbook 374.

If the Contractor fails within the period specified in the notice in writing to show cause to the satisfaction of the Principal why the powers hereinafter contained should not be exercised the Principal, without prejudice to any other rights that he may have under the Contract against the Contractor, may-
(a) take over the whole or any part of the work remaining to be completed and for that purpose and in so far as it may be necessary exclude from the site the Contractor and any other persons concerned in the performance of the work under the Contract; or
(b) cancel the Contract, and in that case exercise any of the powers of exclusion conferred by sub-paragraph (a) of this paragraph."

When the contractor did not complete the work on time the Principal issued a notice under Subclause 44.1. There was no doubt that the Contractor was in default. Some of the delays were attributable to the Principal's failure to provide the necessary materials in accordance with the Contract. The decision of the Principal to issue the notice under Subclause 44.1 was based on 'misleading, incomplete and prejudicial information'.

The Arbitrator (a non-lawyer engineer) would not allow the parties to be legally represented before him. The Arbitrator made an award in favour of the contractor. The Arbitrator found that the Principal was unreasonable in exercising its power to take over the work and exclude the Contractor from the site. The Arbitrator held that the contractor was entitled to recover a sum on a quantum meruit. The Arbitrator calculated the sum to be awarded, added interest and ordered the Principal to pay the costs of the award.

Leave was granted to the Principal to appeal under s. 38 (5) of the Commercial Arbitration Act 1984(NSW) on questions of law.

On appeal it was held by Cole J that the arbitrator's award should be set aside, and the matter referred to him to enter an award in favour of the Principal.

The Contractor then applied for leave to appeal against Cole J's orders. Leave was granted by the NSW Court of Appeal.

The majority of the Court of Appeal (Priestly and Handley JJA) held that the powers conferred on the Principal under Subclause 44.1 were to be exercised reasonably.

In this case the majority found that the Principal had not complied with an *implied term* to exercise the powers reasonably.

Meagher JA decided the matter on the ground that the Principal had not complied with Subclause 44.1 that required the Principal to act on accurate information in forming a view on whether the Contractor had shown cause. Meagher JA found that the Principal had not done so and also found in favour of the Contractor.

The Court restored the Arbitrator's Award in favour of the Contractor with costs.

Carter and Peden favour Meagher JA's approach as within the *show cause* procedure is embodied good faith. This approach does not adopt the difficult *implied term* approach to good faith.

The implication of a term of "good faith and fair dealing" has not been without some equivocation (see *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 (Alcatel) and *Burger King Corp v Hungry Jacks Pty Ltd* [2001] NSWCA 187. In *Alcatel*, Sheller JA stated at 369 that:

> *"The decisions in* Renard Constructions *and* Hughes Bros *mean that in New South Wales a duty of good faith, both in performing obligations and exercising rights, may by implication be imposed on parties as part of a contract."*

In *Alcatel* the lessor of commercial premises was required under the lease to keep the building "in good and substantial repair". The lessor had commissioned a report from a fire engineer. At the lessor's request the local council inspected the premises and found that they did not comply with the relevant legislation. In order to comply with the fire legislation the tenant would be required to vacate the premises. The landlord sought the cost of compliance from the tenant under the terms of the lease. The tenant sought to challenge the decision of the Council but the lessor would not agree to lend its name to the proceedings. The tenant then sought to argue that the lease included an implied term that the lessor would co-operate with the tenant in bringing the action, that is, there was an implied term in the lease of "fair dealing". The lessee alleged that the lessor had exerted pressure on the Council to issue an order that the building did not meet the fire legislation requirements.

Sheller JA after finding that a duty of good faith can be implied into contacts held that there was no reason why such a duty should be implied as part of the lease under consideration. In the type of commercial relationship before him Sheller JA found:

> *"In a commercial context it cannot be said, in my opinion, that a property owner acts unconscionably or in breach of an implied term of good faith in lease of the property by taking steps to ensure that the requirements of fire safety advised by an expert fire engineer should be put in place."*

In *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NAWCA 187 the implied duty of good faith was considered.

In 1973 Hungry Jack's Pty Ltd (HJPL) obtained the right to develop Burger King franchises in Australia. By 1996 it had established some 170 outlets. Under a "Development Agreement" signed by HJPL in 1990 HJPL was required to develop a minimum of four new outlets per year. Each outlet required the legal and operational and financial approval of Burger King Corporation (BKC).

In 1993 BKC began talks with Shell with a view to using service stations as outlets. Initially, HJPL was included in these negotiations.

In 1994 BKC sought to form a bi-partate relationship with Shell to the exclusion of HJPL. In 1994 BKC began to withhold approvals for new outlets by HJPL. In 1996 BKC terminated the Agreement.

HJPL brought an action claiming breach of an implied obligation to act in good faith.

The trial judge, Rolfe J. found:

> *"In the end I am forced to the conclusion that it was in pursuance of a deliberate plan to prevent HJPL expanding, and to enable BKC to develop the Australian market unhindered by its contractual arrangements with HJPL."*

The Court of Appeal held that the third party freeze and the withdrawal of financial and operational approvals by BKC was:

> *" …directed not to furthering its legitimate rights under the Development Agreement but to prevent HJPL from performing its obligations under the Development Agreement."*

The Court of Appeal agreed with the conclusions of the trial judge.

In *Burger King* the motive of BKC was regarded as a crucial factor in determining whether conduct amounting to a breach of the duty of good faith constitutes a breach of contract.

Professor Carter and Dr Peden state that the Court of Appeal in *Burger King* did not distinguish between an implied term of 'reasonableness' and that of 'good faith'.

Fiduciary obligations and good faith

If one party is a fiduciary, that is, in a position of trust and confidence to another party, then they owe a duty of good faith. Accepted fiduciary relationships are: trustee and beneficiary; agent and principal; solicitor and client; employee and employer; director and company and partners. In *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 96-7, Mason J said:

> *" The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position. The expressions "for", "on behalf of", and "in the interests of" signify that the fiduciary acts in a "representative" character in the exercise of his responsibility, to adopt an expression used in the Court of Appeal."*

Arbitrators infrequently have to deal with the fiduciary obligations and good faith.

Good Faith and Unconscionability

Good faith is now a requirement for unconscionability under section 51AC of the *Trade Practices Act* 1974 (Cth) (the Act). Section 51 AC extends the unconscionable conduct provisions of the Act to business transactions involving the supply to or acquisition of goods or services under $3million by a person or corporation, other than a listed public company.[6]

Arbitrators are familiar with *The Shorter Oxford Dictionary* definition of "unconscionable"[7] as:

> *"Showing no regard for conscience, irreconcilable with what is right or reasonable".*

Arbitrators are also familiar with *The Macquarie Dictionary* definition of the term as:

> *"1. Unreasonably excessive. 2. not in accordance with what is just or reasonable: unconscionable behaviour. 3. not guided by conscience; unscrupulous."*

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6 *Miller's Annotated Trade Practices Act* 32th edition 2003, Lawbook Co.

7 see: *Hurley v McDonalds Australia Pty Ltd* [1999] FCA 1728 at paras [22] and [31] (2000) ATPR 41-741 at 40, 585 BS 40, 586; *ACCC v Berbatis Holdings Pty Ltd* [2000] FCA 1376; (2001) ATPR 41-802.

The types of matters to be taken into account in a determination as to whether conduct is unconscionable include:

a the relative strengths of the bargaining position of the parties involved;
b whether, as a result of conduct engaged in by the supplier or acquirer, the person claiming unconscionable conduct was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier or acquirer;
c whether the person complaining of unconscionable conduct was able to understand any documents relating to the supply or possible acquisition or supply of the goods or services;
d whether any undue influence or pressure was exerted or any unfair tactics were used;
e the amount for which, and the circumstances under which, identical or equivalent goods or services could have been acquired from or supplied to someone else;
f the extent to which the conduct was consistent with conduct in similar transactions with other like customers;
g the requirements of any applicable industry code;
h the requirements of any other industry code, if the business consumer acted on the reasonable belief that the supplier would comply with that code;
i the extent to which the supplier unreasonably failed to disclose to the business consumer:
  – any intended conduct of the supplier that might affect the interests of the business consumer; and
  – any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen but which would not be apparent to the business consumer);
  – the extent to which the supplier or acquirer was willing to negotiate the terms and conditions of any contract for the supply of goods or services; and
  – **the extent to which the parties acted in good faith** (my emphasis).

The institution of legal proceedings or a reference to arbitration is not to be taken as evidence of unconscionable conduct. (s51AC(5)).

It is quite possible that as the law on unconscionability develops, the separate nature of the concepts of "good faith" and "unconscionable conduct" or "unconscionability" may not be so distinct.

Agreements to Agree

In *Masters v Cameron* (1954) 91 CLR 353 at 360-361 Dixon J referred to three classes or categories of contracts:

> *"Where parties who have been in negotiation reach agreement upon terms of a contractual nature and also agree that the matter of their negotiation shall be dealt with by a formal contract, the case may belong to any of three classes.*
> *It may be one in which the parties have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of those terms, but at the same time propose to have those terms restated in a form which will be more precise but not different in effect. Or, secondly, it may be a case in which the parties have completely agreed upon all the terms of their bargain and intend no departures from or addition to that which their agreed terms express or imply, but nevertheless have made performance of one or more of those terms conditional upon the execution of a formal document. Or, thirdly, the case may be one in which the intention of the parties is not to make a concluded bargain at all, unless and until they execute a formal contract."*

The three classes or categories of contract have become accepted as part of Australian Contract Law. In the first two classes there is a binding agreement but in the third category there is no binding agreement. Contracts that fall into the second class include contracts where the price has yet to be stipulated. The third class is exemplified by those agreements that are "Subject to…. ."

Arbitrators should now note that there is a fourth class or category of contract. It is "...one in which the parties were content to be bound immediately and exclusively by the terms which they had agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent , additional terms".[8] On appeal in *Baulkham Hills Private Hospital Pty Ltd v G R Securities Pty Ltd and Others*, McHugh JA with whom Kirby P and Glass JA agreed stated:

> *"…the decisive issue is always the intention of the parties which must be objectively ascertained from the terms of the document when read in the light of the surrounding circumstances:* Godecke v Kirwan *(1973) 129 CLR 629 at 633;* Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd *(1985) 2 NSWLR 309 at 332-4,337. If the terms of a document indicate that the parties intend to be bound immediately, effect must be given to that intention, irrespective of the subject matter, magnitude or complexity of the transaction."*

The fourth class of contracts has been accepted in the following cases: *Tern Minerals NL v Kalbara Mining NL* (1990) 3 WAR 486; *Heysham Properties Pty Limited v Action Motor Group Pty Limited & Ors* (1996) 14 BCL 145; *Telstra Corporation Limited v Australis Media Holdings* (1997) 24 ASCR 55; *Brunninghausen v Galvanics* (1999) 46 NSWLR 538.

In accepting this class of contract, Ipp J in *Anaconda Nickel Ltd v Tarmoola Pty Ltd* (2001) 22 WAR 101 at 110 stated:

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8 (see: Knox CJ Rich and Dixon J in *Sinclair, Scott & Co v Naughton* (1929) 43 CLR 310 at 317 following Lord Loreburn in *Love & Stewart v S Instone & Co* (1917) 33 TLR 475 at 476 cited by McLelland J in *Baulkham Hills Private Hospital Pty Ltd v G R Securities Pty Ltd and Others* (1986) 40 NSWLR 622 at 628.

> *"It is well recognised that parties may enter into a valid contract containing a limited number of terms comprising those terms essential to the bargain that they wish to conclude, in the expectation that at a later date a further contract will be arrived at containing additional terms that would facilitate and clarify the initial contract. That is to say, a binding contract may be arrived at even though it leaves unresolved many matters which might arise in the future."*

This fourth class has been accepted in the context of open-ended contracting practice.[9]

The Full Federal Court of Australia in *Graham Evans Pty Ltd v Stencraft Pty Ltd* 16 BCL 335 (French, Whitlam and Dowsett JJ)[10] applied the fourth class of contracts in holding that parties may be bound immediately by the terms, which they agree upon, whilst expecting to negotiate the terms of, and make a further contract in substitution for the first contract.

Conclusions:

The state of law in Australia in regard to the concept of "good faith" in contracts is in a state of flux until the High Court rules on this topic.

Arbitrators may be better advised if they followed Carter and Peden and avoided implying a term of "good faith" into contracts. Instead they should rely upon the inherent quality of "good faith" as the essence of all contracts.

In addition, Arbitrators when construing or interpreting the terms in a contract, adopt a "commercial construction", that is, one that focuses on the giving effect to the intention of the parties. If this approach is adopted then recourse to the need to imply a term of good faith into the contract will not be needed.

There is authority though not without some equivocation from both the NSW Court of Appeal and from the Federal Court that of a term of "good faith and fair dealing" can be implied into contracts. It is quite possible that with the inclusion of good faith as a requirement in the section 51AC of the Trade Practices Act that the distinction between "good faith" and "unconscionability" may not be as distinct in the future.

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9 see: McLauchlan, *"Some Further Thoughts on Agreements to Agree"* (2001) 7 NZBLQ 156 at 164-5; C.F.E. Rickett, *"Some Reflections on Open-Textured Commercial Contracting"* (2001) AMPLA Yearbook 374 at 404 et seq.; see also *Pagnan S.p.A. v Feed Products Ltd* [1987] 2 Lloyd's Rep 601.

10 see also transcripts of the application for special leave to the High Court on which leave was refused.