

The Existence of an Implied Term of Good Faith in Commercial Agreements

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Introduction

- Judicial acceptance of an implied term of good faith in Australia
- Whether the term is implied in all agreements
- What does the term mean?
- What remedies apply where there is a breach of the term?

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Implied terms – general rules and principles

- Implied in fact (ad hoc)
 - Necessary to give business efficacy to the contract
 - Reflects the actual intention of the parties drawn from the circumstances of the particular contract
 - Implied only in the contract that is before the Court
- Implied by law
 - By statute e.g. s.13 Insurance Contracts Act (Cth)
 - Implied from the nature of the contract or the obligations it creates –
 - Is a legal incident of a particular class of contract and is implied in all contracts of that class

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Burger King and Hungry Jacks

- Burger King – franchisor and second largest food chain in the world
- Hungry Jacks – Aust. Franchisee of Burger King
- 1990 the parties contractual relationship was governed by 4 main agreements (Settlement agreement, Development agreement, Service Agreement Registered User's agreement) and an individual agreement in respect of each Hungry Jack store within Aust.

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Burger King and Hungry Jacks

- The Development agreement:
 - gave Hungry Jacks an unrestricted, non exclusive right to develop throughout Aust.
 - required Hungry Jacks to develop at least 4 restaurants per year in WA, SA and Qld
 - term of the agreement was for a period of 5 years, with provision for 3 renewals for the same period
 - contained an express term enabling Burger King to terminate the agreement upon any breach by Hungry Jacks of its obligations under the agreement. Termination was however subject to Burger King providing a 30 day notice to Hungry Jacks for any breach that was the subject of cure.

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Hungry Jacks v Burger King

- HJ contended that the Development agreement contained the following implied terms:
- that BK would do all that was reasonably necessary to enable HJ to enjoy the benefits of the agreement (duty to co-operate)
 - that BK was required to act reasonably in exercising its powers under the agreement
 - that BK was obliged to act in good faith in the exercise of its powers under the agreement

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Where it all began

Renard Constructions (1992) 26 NSWLR 234

- Priestly JA
 - Implied (ad hoc and in law) an obligation of "reasonableness" in performance of the power to terminate (at 263)
 - "reasonableness" has much in common with the notions of "good faith" (at 263)
 - "...all strands of the community, have grown use to the courts applying standards of fairness to contract which are wholly consistent with the exercise in all contracts of a duty of good faith and fair dealing in its performance. ..." (at 268)

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Where it all began (cont)

Renard Constructions (1992) 26 NSWLR 234

- Handley JA
 - Implied a term requiring the termination power to be exercised "honestly" and "reasonably" (at 279)
 - the requirement of "honesty" applies to all contracts
 - the requirement of "reasonably" was implied from the express terms of the termination provision which included a requirement that:
 - the principal give the contractor notice to show cause
 - the contractor respond to the satisfaction of the principal and
 - disputes be resolved by arbitration

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Where it all began (cont)

Renard Constructions (1992) 26 NSWLR 234

- Meagher JA
 - "reasonableness" can not be imported as a limitation on the exercise of the power to terminate

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Is the term implied in all contracts? (cont)

- Burger King Corporation v Hungry Jack's Pty Ltd [2001] NSWCA 187 at [159]
 - The "courts have proceeded on the assumption that there may be implied, as a general incident of a commercial contract, terms of good faith and reasonableness"
- Overlook Management BV v Foxtel Management Pty Ltd (2002) ATPR (Digest) 46-219 at [62]
 - "An additional term implied by law into commercial contracts is a term requiring the exercise of good faith in the performance of the contract. This is now in this State a legal incident of every such contract."

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Is the term implied in all contracts? (cont)

Vodafone Pacific Ltd v Mobile Innovations Ltd [2004] NSWCA 15

- The decision of the Court in *Burger King* "fell short of, indeed rejected, treating commercial contracts carrying the implied term as a legal incident" at [189]
- However, assumed that the term was implied and found that it was excluded by an express term of the contract that excluded all implied terms, conditions and warranties to the full extent permitted by law (at [191])

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Is the term implied in all contracts? (cont)

Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd [2005] FCA 288

- Finkelstein J "... the duty of good faith is an incident (not ad hoc implied term) of every commercial contract, unless the duty is either excluded expressly or by necessary implication." at [64]

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Is the term implied in all contracts? (cont)

Playcorp Pty Ltd v Taiyo Kogyo Ltd [2003] VSC 108

- Hansen J: contract between two independent parties – each party was a substantial organization well able to attend to its own interests (at [267])

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Is the term implied in all contracts? (cont)

Botanic Gardens and Domain Trust v South Sydney City Council (2002) 186 ALR 289

- Kirby J: conflicts with concepts of economic freedom and inconsistent with the law in Australia relating to implied terms (at 312)
- Callinan J: “a duty of good faith may deny a party an opportunistic or commercial exercise of an otherwise lawful commercial right” (n 32 at 327)

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Recent decisions

- Esso Australia Resources Pty Ltd v South Pacific Petroleum NL (receivers and managers appointed) [2005] VSCA 228

Warren CJ:

- there is a clear recognition of good faith
- if there is a duty of good faith it is owed mutually
- but the interests of certainty in contractual activity should only be interfered with when the relationship between the parties is unbalanced and one party is at a substantial disadvantage

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Esso Australia (cont)

Buchanan JA:

‘If a contractual right or power, which is intended to advance only the interest of the party on whom it is conferred, is fettered by an implied obligation of good faith, resort to the duty may become an obstacle to the promotion of that party’s legitimate interests’

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Recent decisions (cont)

CGU Workers Compensation (NSW) Limited v Garcia [2007] NSWCA 193

Mason P at [131] to [143]: there is no authority to support the proposition of an implied term of good faith in every agreement. It may however be implied as a matter of law in specific classes of contract or to give business efficacy to a particular agreement

Insight Oceana Pty Ltd v Phillips Electronics Australia Ltd [2008] NSWSC 710

Bergin J at [177] implied the term to give business efficacy to the agreement

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Summary of circumstances where a term of good faith may be implied

- Not implied in all commercial contracts
- May be implied, subject to the express terms of the contract, as a matter of law in specific classes of contract or to give business efficacy to a particular agreement
- Will not be implied where ‘commercial leviathans’ are contractually engaged
- Has been implied in the following class of contracts
 - Construction and Development
 - Franchise
 - Motor dealers and Telecommunications distribution agreement
 - Commercial lease
 - Pre award tender
 - Management agreement

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What does the term mean?

- Sir Anthony Mason – 1993 Cambridge lecture
 - Concept embraces three related notions
 - (1) an obligation on the parties to co-operate in achieving the contractual objects;
 - (2) honest standards of conduct; and
 - (3) compliance with standards of conduct which are reasonable having regard to the interest of the parties

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What does the term mean? (cont)

Overlook Management BV v Foxtel Pty Ltd (2002) ATPR (Digest) 46-219

- Barrett J:
 - The term underwrites the spirit of the contract
 - It is a duty to recognize and have regard to the legitimate interest of both parties in the enjoyment of the fruits of the contract as delineated by its terms
 - Precludes cynical resort to the black letter – but not to the extent of subordinating self interest
 - Obligation to eschew bad faith

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What does the term mean? (cont)

Commonwealth Bank of Australia v Spira [2002] NSWSC 905

- Gazell J at [155]:
 - "The party is precluded from cynical resort to the black letter, but is not fixed with a duty to subordinate self interest entirely. The duty is not one to prefer the interest of the other contracting party"

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What does the term mean? (cont)

Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd (1999) ATPR 41-703

- Finkelstein J at 43,014
 - The term "imposes an obligation upon that party not to act capriciously. It would not operate so as to restrict actions designed to promote the legitimate interests of that party. That is to say, provided a party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will be ordinarily satisfied."

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What does the term mean? (cont)

Esso Australia Resources Pty Ltd v Southern Pacific Petroleum [2004] VSC 477

- Hollingsworth J at [120-127]:
 - Involves the notions of fairness and reasonableness but not to the exclusion of a party being able to act in a way that protects its own interests

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What does the term mean? Summary

- Honesty
- Reasonableness
- Fairness
- Due regard to legitimate interests of parties
- Exercising contractual powers for a legitimate purpose
- Avoid bad Faith
 - Exercising contractual powers for an extraneous purpose
 - Selfish behaviour calculated to destroy position of other party
 - Arbitrary and capricious conduct
 - Conduct that is oppressive or unfair in its result

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Remedies where term is breached

- A breach of an implied term of good faith does not stand alone – the express term which has not been exercised in good faith will also have been breached
- Accordingly, the remedies flow from the express term and the usual contract remedies apply:
 - Damages
 - Injunctions
 - Specific performance

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Conclusions

- Australian courts have accepted the existence of an implied term of good faith in commercial contract
- The term is not implied in all commercial contracts
- When the term will be implied is not clear but it has been implied ad hoc and in law
- The meaning of the term is imprecise and uncertain, but it does not prevent a party pursuing its legitimate interests under the agreement or require a party to have regard to the interest of the other party
- The effect of the term may place a fetter on the exercise of contractual rights and obligations
- Where there is a breach the normal contractual remedies apply

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