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Discreet Digression: The Recent Evolution of the Implied Duty of Good Faith

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Discreet Digression: The Recent Evolution of the Implied Duty of Good Faith

Abstract

In 1992, the NSW Supreme Court's decision in *Renard Constructions (ME) Pty Ltd v Minister for Public Works (Renard)* enlivened a controversial principle: that a duty of good faith could in some circumstances be implied into a contract. Barely a decade later, with the decision in *Overlook Management BV v Foxtel Management Pty Ltd (Overlook)*, the orthodox judicial view was that the duty of good faith was implied into a certain class of contracts as a matter of law. During this rapid development there were occasional judicial dissents, but without sufficient consistency or volume to be viewed as an authoritative alternative. At the head of the line of cases born of *Renard*, *Overlook* remains the clearest and furthest-reaching statement of law on the implication of a duty of good faith.

Keywords

duty of good faith, discreet digression

DISCREET DIGRESSION: THE RECENT EVOLUTION OF THE IMPLIED DUTY OF GOOD FAITH

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Introduction

In 1992, the NSW Supreme Court's decision in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*¹ (*Renard*) enlivened a controversial principle: that a duty of good faith could in some circumstances be implied into a contract. Barely a decade later, with the decision in *Overlook Management BV v Foxtel Management Pty Ltd*² (*Overlook*), the orthodox judicial view was that the duty of good faith was implied into a certain class of contracts as a matter of law. During this rapid development there were occasional judicial dissents, but without sufficient consistency or volume to be viewed as an authoritative alternative. At the head of the line of cases born of *Renard*, *Overlook* remains the clearest and furthest-reaching statement of law on the implication of a duty of good faith.

Commentators have written extensively on the topic.³ Those who take a critical view tend to focus on the inappropriateness of implication by law for the task at hand. Implication by law cannot properly take account of the circumstances of the case, the terms of the contract or – fundamentally – the intention of the parties; and without this context in which to determine the content of the term, the duty implied must be defined in the abstract. Implication by law is a blunt instrument.

As a result, the duty of good faith is in a legal recession. Some benches have found it easy to express broad support for the principle, generally while declining to imply a duty or fully explain what it means; others have pattered around deferentially without coming to a firm conclusion. The implied duty of good faith has become an easy argument to make, but a difficult one to resolve. The law on the duty has ceased to develop, leaving *Overlook* as an uncertain high-watermark. Many are looking to the High Court for direction.⁴

In the meantime, a number of less celebrated cases provide a hint of a new – or at least intermediate – direction. This new breed of cases – epitomised by *Maitland Main Collieries Pty*

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¹ (1992) 26 NSWLR 234.

² [2002] NSWSC 17.

³ See, eg, J W Carter and Elisabeth Peden, 'Good faith in Australian contract law' (2003) 19 *Journal of Contract Law* 155; Elisabeth Peden, 'Incorporating Terms of Good Faith in Contract Law in Australia' (2001) *Sydney Law Review* 222; Robert McDougall J, 'The implied duty of good faith in Australian contract law' (2006) 108 *Australian Construction Law Newsletter* 28; Adrian Baron, "'Good faith" and construction contracts – from small acorns large oaks grow' (2002) 22 *Australian Bar Review* 1; Bill Dixon, 'Common law obligations of good faith in Australian commercial contracts – a relational recipe' (2005) 33 *Australian Business Law Review* 87; J W Carter and Andrew Stewart, 'Interpretation, good faith and the 'true meaning' of contracts: the Royal Botanic decision' (2002) 18 *Journal of Contract Law* 1; Tyrone Carlin, 'The rise (and fall?) of implied duties of good faith in contractual performance in Australia' (2002) 25(1) *University of New South Wales Law Journal* 99; Adam Wallwork, 'A requirement of good faith in construction contracts?' (2004) 20 *Building and Construction Law* 257; Bill Dixon, 'What is the content of the common law obligation of good faith in commercial franchises?' (2005) 33 *Australian Business Law Review* 207. Finally, Elisabeth Peden, *Good Faith in the Performance of Contracts* (2003), stands out for its thoroughness.

⁴ See, eg, McDougall J, above n 3, 36; Carter and Stewart, above n 3, 12.

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*Limited v Xstrata Mt Owen Pty Limited*⁵ (Maitland) – take an approach grounded in implication in fact rather than implication by law. These cases consider whether a duty of good faith is appropriate on the facts of the case and in light of the terms of the contract.

While not without its weaknesses, implication in fact is a much fairer and more practical approach than implication of a duty of good faith by law. It has identifiable substance, which the construction approach proposed as an alternative lacks, upon which the duty of good faith can develop as a distinct feature of modern Australian contract law. Moreover, it allows the content of the duty to be determined in the context of a factual matrix rather than in the abstract. From such factual determinations, and their rationales, a coherent and justifiable doctrine can be built over time. If a duty of good faith is to be implied in contracts, implication in fact is a preferable method to implication in law.

The premise of this paper

It is necessary to make clear the objective of this paper. The aim of this paper is not to show that the implication of a duty of good faith ought to be part of Australian law. That is very much open for debate. The author is sympathetic to the argument that good faith has long been recognised in a variety of principles, and infuses contract law sufficiently without the implication of a particular duty. Our courts have proven themselves adept at dishonouring actions taken in bad faith without recourse to an implied duty being necessary.

Instead, this paper is written on the premise that the implication of a duty of good faith has – rather rapidly, and for better or for worse – become part of our contract law. Accepting on the basis of present judicial authority that a duty of good faith is to be implied, this paper seeks to argue that it ought to be implied in fact rather than in any other manner. Such an approach will better achieve the underlying purpose, and better facilitate the development of a coherent doctrine of good faith in Australia. Implication in fact is a pragmatic prescription, not an ideal solution; it is recommended as a realistic path out of the present conceptual quagmire.

The rise and rise of the implied duty of good faith

The debate surrounding the implication of a duty of good faith started, for present purposes, with the decision in *Renard* in 1992. As has been pointed out by other commentators, only one member of three in the Court of Appeal, Priestley JA, dealt with the question, and only as obiter.⁶ Nevertheless, subsequent cases have tended to trace their authority back to *Renard*.⁷

The next ten years of authority saw the remarkably rapid rise of the implied duty of good faith. Carlin traces the development of the doctrine in great detail in his article ‘The Rise (and Fall?) of Implied Duties of Good Faith’.⁸ *Renard* begat *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney*,⁹ in which a notably restrained Kirby P (as he then was) declined the opportunity to quash the emerging line of authority, instead

⁵ [2006] NSWSC 1235.

⁶ See, eg, Wallwork, above n 3, 265; Carlin, above n 3, 105.

⁷ As an exception, Carlin (above n 3, 105) notes that in *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187, Sheller, Beazley and Stein JJA recognise Priestley JA's comments as obiter (at [154]). This is strictly true, but in fact the passage evidences the manner in which *Renard* achieved widespread acceptance: ‘[w]e have referred and relied extensively upon his Honour's judgment in so far as it deals with an implied obligation of good faith, as it provides, obiter, authoritative background to the development of the law on this issue’.

⁸ Carlin, above n 3.

⁹ (1993) 31 NSWLR 91.

deferring to *Renard* on the basis of precedent.¹⁰ *Hughes*, bolstering *Renard*, begat any number of cases: *Hughes Aircraft Systems International v Airservices Australia*;¹¹ *Alcatel Australia Ltd v Scarcella*;¹² *Far Horizons Pty Ltd v McDonalds Australia*;¹³ *Burger King Corp v Hungry Jack's Pty Ltd*;¹⁴ *Apple Communications Ltd v Optus Mobile Pty Ltd*;¹⁵ and *Commonwealth Bank of Australia Ltd v Spira*.¹⁶

In the course of this evolution, the duty was established as one implied by law and potentially applicable to all commercial contracts. In *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd (Garry Rogers)*, Finkelstein J stated that 'recent cases make it clear that in appropriate contracts, perhaps even all commercial contracts, such a term will ordinarily be implied; not as an ad hoc term (based on the intention of the parties) but as a legal incident of the relationship'.¹⁷ Similarly, in *Overlook Barrett* J held that '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 [New South Wales] a legal incident of every such contract'.¹⁸ Clearly, by *Overlook* the implication of a duty of good faith by law was well recognised.

Since *Overlook*, there have been a handful of decisions endorsing the approach to the implied duty of good faith taken in that case.¹⁹ *Vodafone Pacific Ltd v Mobile Innovations Ltd* held that '[a]n obligation of good faith and reasonableness in the performance of a contractual obligation or the exercise of a contractual power may be implied as a matter of law as a legal incident of a commercial contract'.²⁰ The use of the word 'may' is notable; Giles JA later explained that he did not think that commercial contracts were a class, wide and indeterminate as it would be, into which such a term is necessarily implied by law.²¹ Nevertheless, *Vodafone* clearly approves the mode of implication, if not the scope of its application.

Doubt, avoidance and recriminations

Academic criticism

However even during that surge – indeed, perhaps because of it – there was considerable resistance to the direction which was being taken. Criticism came thick and fast from the academy.

There is little dispute amongst commentators that the doctrine of good faith has developed markedly since *Renard*, or that its development has been a significant event.²² There has been

¹⁰ *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 91, 93.

¹¹ (1997) 76 FCR 151.

¹² (1998) 44 NSWLR 349.

¹³ [2000] VSC 310.

¹⁴ [2001] NSWCA 187.

¹⁵ [2001] NSWSC 635.

¹⁶ [2002] NSWSC 905.

¹⁷ *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703, 43-014.

¹⁸ *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 17, [62].

¹⁹ See, eg, *Varangian Pty Ltd v OFM Capital Ltd* [2003] VSC 444; *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288.

²⁰ *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15, [125].

²¹ *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15, [191].

²² Carter and Stewart describe it as '[p]erhaps the most important unresolved issue in Australian contract law today' (Carter and Stewart, above n 3, 9).

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general support for good faith as a principle of contract law in Australia.²³ Comparative references note the prevalence of the concept in other jurisdictions, especially European civil law jurisdictions and the United States.²⁴ In general, good faith has either been seen as an overdue arrival or the emergence of a unifying principle from the primordial soup of the common law.

Instead, the focus of academic disapproval is the theoretical inconsistency of the approach taken in the recent evolution of good faith. The criticism is that the implication of a duty of good faith in the manner derived from *Renard* does not cohere with fundamental principles underlying Australian contract law; that it conflicts with more superficial concepts within it; that it stretches the rules of implication; that it is – in a word – ugly. Carlin, for example, bemoans ‘the tortured development of the doctrine...the hallmark of which seems to have been misconstruction heaped upon misconstruction’.²⁵

Carter and Peden, whilst endorsing good faith as inherent in contract law, seem positively repulsed by the idea that it be implied by law into all commercial contracts.²⁶ Perhaps the leading authority in the area, Elisabeth Peden has consistently and cogently argued that the implication of good faith by law is inconsistent with the law of contract.²⁷

Judicial dissent

A number of judges clearly disagreed with the approach taken in the leading cases, and found opportunities and means by which to express that disagreement. In *GSA Group v Siebe PLC*, Rogers CJ Comm D was critical of the imposition of a duty of good faith upon parties ‘who are quite able to look after their own interests...especially where all of the parties are wealthy, experienced, commercial entities’.²⁸ Such parties might, as they had in that case, take thoroughly adversarial positions. Implication of a duty of good faith would be inappropriate in such circumstances.

In the Federal Court in the same year, Gummow J stated in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* that the implication of a duty of good faith by law was not required by any authority.²⁹ Gummow J also expressed disquiet at judicial reference to ‘community standards’.³⁰ His Honour recognised that good faith could be seen as informing a range of remedies and principles, particularly in equity, but considered that ‘it requires a leap of faith to translate these well-established doctrines and remedies into a new term...implied by law’.³¹

The difference between implication by law and in fact

Implication by law is the implication of a term into a contract based upon its membership of a certain class of contracts. The term is presumed to be part of all contracts of that type, but can be excluded by clear words to that effect.³² The problem, in relation to the topic at hand, is that this is not sensitive to the circumstances of the parties or the wording of the contract

²³ Carlin notes ‘the strong support for the general implication of a duty of good faith in contractual performance in Australia’ (Carlin, above n 3, 122).

²⁴ See, eg, Carter and Peden, above n 3, 171; Peden (2003), above n 3, 10.

²⁵ Carlin, above n 3, 122.

²⁶ Carter and Peden, above n 3.

²⁷ Peden (2001), above n 3; Peden (2003), above n 3; Carter and Peden, above n 3.

²⁸ *GSA Group v Siebe PLC* (1993) 30 NSWLR 573, 579.

²⁹ *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393, 407.

³⁰ *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393, 405.

³¹ *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393, 406.

³² *Castlemaine Tooheys Ltd v Carlton & United Breweries* (1987) 10 NSWLR 468.

(beyond clear exclusions). It can only be said to be based on the intention of the parties to the extent that all parties to the given type of contract are presumed to have intended to include it.

Further, implication by law is an all or nothing approach. Either the contract is governed by a duty of good faith, or it is not. The individual mechanisms of the contract cannot be assessed on their terms to determine whether a duty of good faith is appropriate, nor can the circumstances in which the parties contracted or the objective which they wished to achieve. As a result, the duty of good faith, if it exists, is a duty 'at large', and there is little context in which to determine its content.

Basing the implication of a duty of good faith on the particular circumstances of the case is a preferable approach. It permits sensitivity to more than just clear words of exclusion, and a range of factors enter into consideration: what the parties sought to achieve; the circumstances of the contract; the relationship between the parties; and the terms used in any given clause, whether a clear exclusion or not. Examining the duty of good faith in the factual matrix of the agreement provides a context in which the content of the duty can be determined.³³ In good common law style, it allows judges to define the duty of good faith as the case requires – on the facts – providing a jurisprudence from which general principles can be drawn as they emerge, rather than relying upon the divination of a flawless principle in the abstract. Most importantly, the touchstone of implication in fact is the core concern of the law of contract: the intention of the parties.

Discreet digression – implication in fact in action

A number of recent cases have discreetly adopted an approach which is best understood under the rubric of implication in fact. These cases demonstrate in their reasoning and outcomes that implication in fact is a pragmatic and useful method by which to deal with the duty of good faith, and in their existence that the implication of a duty of good faith in fact rather than by law is endorsed by a small but growing body of recent authority.

*Council of the City of Sydney v Goldspar Australia Pty Ltd*³⁴ (*City of Sydney*) provides a good example. After considering the 'bewildering' array of authorities and academic views,³⁵ Gyles J opted to 'concentrate upon the particular contractual provision in question, in the particular contract, in the particular circumstances of the case' in order to determine whether a duty to act in good faith ought to be implied or not.³⁶ In doing so, his Honour eschewed the implication by law approach, expressed so clearly in the same court in *Garry Rogers*, in favour of implication in fact.

An equally clear example of the change of approach is found in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL*³⁷ (*Esso*). In that case the Court refused to imply a duty of good faith to constrain Southern Pacific's use of its power of assignment. Warren CJ considered that 'where commercial leviathans are contractually engaged, it is difficult to see that a duty of good faith will arise'.³⁸ Buchanan JA, with whom the other members of the Court agreed, made a similar observation, reserving the duty for cases in which it can 'protect

³³ See also Paul Finn, 'Good Faith and Fair Dealing: Australia' (paper delivered at the Commercial Good Faith Conference, Auckland New Zealand, 2 September 2005) 7. Finn J considers a 'reasonable expectations' approach, the greatest merit of which is 'its concern with the context of a relationship'.

³⁴ [2006] FCA 472.

³⁵ *Council of the City of Sydney v Goldspar Australia Pty Ltd* [2006] FCA 472, [166].

³⁶ *Council of the City of Sydney v Goldspar Australia Pty Ltd* [2006] FCA 472, [168].

³⁷ *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228.

³⁸ *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [4].

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a vulnerable party from exploitive conduct which subverts the original purpose for which the contract was made'.³⁹ His Honour added that 'implication in this fashion is perhaps ad hoc implication...rather than implication as a matter of law'.⁴⁰

Returning to New South Wales, in *Australian Hotels Association (NSW) v TAB Limited (Australian Hotels)* Bergin J held that commercial contracts are not a class of contracts into which an obligation of good faith is implied by law, quoting a passage from Buchanan JA's judgment in *Esso*.⁴¹ Her Honour then quoted from Warren CJ's judgment in the same case, approving the reluctance to imply a duty of good faith where 'commercial leviathans' are involved.⁴² In light of this, Bergin J stated that 'whether such an obligation is implied...will depend upon the terms of the particular contract, and the other matters to which it is permissible to have regard'.⁴³ The preference, again, is for implication in fact.

Maitland Main Collieries Pty Limited v Xstrata Mt Owen Pty Limited

Maitland is typical of the new breed of decisions in this area. *Maitland* centred upon a deed executed by the plaintiff, Maitland Main Collieries (MMC), and the defendant, Xstrata Mt Owen (Xstrata). Xstrata wished to construct a rail link from its mine at Mt Owen to the main railway line, crossing an area which could be subject to subsidence from underground mining proposed by MMC. The parties entered into negotiations. MMC sought certain guarantees from Xstrata before acquiescing in the construction of the link, in order to alleviate three concerns: potential liability for subsidence damage to the rail link; sterilisation of coal deposits; and increased difficulty in obtaining mining approvals.

The deed which resulted from the negotiations was remarkably – and, in hindsight, imprudently – brief, and disputes on its meaning were not long in the making. The factual circumstances in which they arose are not immediately relevant, but resulted in MMC seeking, *inter alia*, two salient declarations: that the deed contained an implied term requiring Xstrata to 'act reasonably and in good faith in the performance of its obligations'; and that that term had been breached.

In determining whether the deed contained an implied duty of good faith, Bergin J referred to the judgment of Warren CJ in *Esso* discussed above.⁴⁴ Warren CJ found it 'difficult to see that a duty of good faith will arise' where 'commercial leviathans are contractually engaged'; Bergin J, as she had done in *Australian Hotels*,⁴⁵ explained that such an implication depended upon the particular contract. According to her Honour, the presence or absence of a duty to act reasonably and in good faith 'will depend on the nature of the obligations in the contract...Commercial contracts are not a class of contracts that have an implied obligation of good faith'.⁴⁶

Bergin J went on to consider each clause of the contract individually in order to determine whether that clause ought to be subject to a requirement of good faith. Where the duty was justified as a matter of construction, in light of the intention of the parties, it was implied.⁴⁷ In the circumstances as they were in *Maitland*, Bergin J considered that the duty of good faith

³⁹ *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [25].

⁴⁰ *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228, [25].

⁴¹ *Australian Hotels Association (NSW) v TAB Limited* [2006] NSWSC 293, [75].

⁴² *Australian Hotels Association (NSW) v TAB Limited* [2006] NSWSC 293, [77], [80].

⁴³ *Australian Hotels Association (NSW) v TAB Limited* [2006] NSWSC 293, [78].

⁴⁴ See above n 38 and accompanying text.

⁴⁵ See above nn 42 and 43 and accompanying text.

⁴⁶ *Maitland Main Collieries Pty Limited v Xstrata Mt Owen Pty Limited* [2006] NSWSC 1235, [56].

⁴⁷ *Maitland Main Collieries Pty Limited v Xstrata Mt Owen Pty Limited* [2006] NSWSC 1235, [56]-[59].

was applicable to two of the clauses: the obligation that Xstrata and its contractors and agents abide by conditions imposed upon the use of the rail link; and the indemnity that Xstrata gave to MMC regarding damage to the rail link due to subsidence and the cost of extra drainage work. Bergin J refused to recognise a duty of good faith at large, outside of the operation of the particular clauses.

Bergin J's approach in *Maitland* demonstrates clearly the suitability of implication in fact for the duty of good faith. Bergin J examined the particular clauses of the contract and the circumstances in which it was agreed. Her Honour approached the duty of good faith with the intentions of the parties foremost in mind. The resulting examination is practical, commercially sensitive and realistic.

Revisiting *Renard*

Although it is perhaps a surprising revelation in light of intervening developments, Priestley JA actually considered both implication in fact and implication by law in *Renard*.⁴⁸ When considering implication in fact, his Honour examined individually the clause in question and its subclauses, as well as the intention of the parties.⁴⁹ His Honour's conclusion was that 'the particular contract in this case contains the terms implied ad hoc'.⁵⁰ Moreover, Priestley JA cited considerable authority for this approach, no less than the High Court⁵¹ in *Meehan v Jones*⁵² and the NSW Court of Appeal in *Progress & Properties (Strathfield) Pty Ltd v Crumblin*⁵³ (*Progress & Properties*).

Unfortunately, neither of these cases offer compelling authority for Priestley JA's judgment. *Meehan v Jones* exemplifies a court divided: Mason and Wilson JJ held that an obligation of honesty should be implied, but that there was no need to decide whether an obligation to act reasonably (commonly seen as contained within an implied duty of good faith) existed; Gibbs CJ concurred on the question of honesty but declined to imply a duty to act reasonably based on the business efficacy rule; Murphy J considered a duty of honesty to add nothing and a duty to act reasonably unwarranted; and Aickin J passed away before judgment was given in the case. *Progress & Properties* adds little more, acknowledging the split in authority in *Meehan v Jones* and favouring the implication of a duty of reasonableness in almost identical circumstances. The net result is a weak authority for the implication of a duty of reasonableness, at least where completion of a sale is conditional upon the purchaser finding satisfactory finance. The most that can be said is that these cases do not exclude the use of implication in fact in this manner.

Priestley JA went on to consider implication by law. His Honour considered that the contract in question was 'an example of a wider and common class of contract...in which one party promises to build a work of some size for the other party'.⁵⁴ However, even in considering implication by law for this nominal class of contracts, Priestley JA constrained the scope of the implied duty of reasonableness to the particular clauses in issue in the case then at hand.⁵⁵ As a consequence, any duty of reasonableness implied by law derived from *Renard* should be circumscribed very tightly to the class of contract described, in which there are powers invested in the principal based on a contractor's failure to show cause, and to those clauses

⁴⁸ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 257-8.

⁴⁹ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 256-60.

⁵⁰ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 260.

⁵¹ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 260.

⁵² (1982) 149 CLR 571.

⁵³ (1984) 3 BPR 9496.

⁵⁴ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 261.

⁵⁵ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 262

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only. This is a very narrow approach, and one which conforms much more closely to the approach in *Maitland* than a broad implication by law.

Finally, in case the class of contract described was not a proper one for the purposes of implication by law, his Honour turned to another argument. With respect, that argument was a misunderstanding of an earlier High Court authority, *Gullett v Gardner*.⁵⁶ In *Gullett v Gardner*, Dixon J implied a term based on the intention of the parties, stating that '[t]he intention is to be gathered from what they have said and done, and concerns what each party to the contract had the right to expect, but it does not necessarily mean an enquiry into their actual mental state'.⁵⁷ Priestley JA reasoned that if the parties' mental state was not to be considered, then the Court was 'deciding what implied obligation would be attached to a contract, irrespective of the actual intention of the parties and thus either implication by law rather than ad hoc, or at least as a hybrid between the two'.⁵⁸ Respectfully, his Honour conflated the lack of enquiry into the parties' 'actual mental state' with a lack of consideration of 'the actual intention of the parties'. The intention of the parties was considered by Dixon J, it was simply considered on the basis of objective evidence rather than subjective evidence. Hence, the implication was made in fact, not by law.

Priestley JA's judgment can be seen to rest much more comfortably, if not solely, on implication in fact rather than implication by law. Implication in fact is considered first, and the conclusion is decisive. On the other hand, the consideration of implication by law is much less convincing, and, even if valid, is restricted to a very narrow ambit. If an approach to the implied duty of good faith is to be drawn from Priestley JA's judgment in *Renard* – which, as noted above, was obiter as regards this issue – it is that the implication of a duty of good faith ought to be an implication in fact, based on the intention of the parties. In addition, Handley JA implied a requirement of reasonableness into one of the clauses of the contract in a manner which, although not expansively explained, is best described as implication in fact.⁵⁹ As a result, *Maitland* and the other recent cases discussed above arguably conform more closely to *Renard* than to the series of cases culminating in *Overlook* and *Garry Rogers*.

Implication in fact versus 'construction'

Criticisms of implication in fact

As noted above, Elisabeth Peden has written extensively on the issue of good faith. Peden has cogently criticised the case law which has emerged from *Renard*.⁶⁰ In her book on the subject,⁶¹ as well as identifying the difficulties with implying a duty of good faith by law, Peden highlights the key weakness in the doctrine of implication in fact: the lack of certainty in the definition and application of the tests for the implication of a term in fact enumerated in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*⁶² (*BP Refinery*), in particular those of obviousness and necessity for business efficacy. The flexibility of these so-called 'tests' can

⁵⁶ (1948) 22 ALJ 151.

⁵⁷ Quoted by Priestley JA from the High Court transcript in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 263. The same words in the past rather than present tense are found in (1948) 22 ALJ 151, 155.

⁵⁸ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 263.

⁵⁹ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 280.

⁶⁰ See above n 27 and accompanying text.

⁶¹ Peden (2003), above n 3.

⁶² *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266.

conceal policy judgments as to whether a term of good faith ought to be implied in a contract.⁶³

In fact, in *Renard* itself Priestley JA noted that the tests of business efficacy and obviousness could prove difficult in the context of the duty of good faith;⁶⁴ and in *Maitland* and other cases these tests have been largely overlooked. As Priestley JA foreshadowed, these recent cases have considered the issues embodied by the requirements enumerated in *BP Refinery* in a 'more general way'.⁶⁵ This is not to avoid the question – Peden's criticisms are valid. The tests are notoriously flexible, and at worst are simply masks for policy decisions, a basis on which the court can select the outcome which it considers fairest.

However, these criticisms do not compromise the relevance of implication in fact in dealing with the duty of good faith. First, the tests for implication in fact are unduly flexible in general, not just with regard to the duty of good faith. Therefore, implication in fact is just as acceptable in this context as it is in any other; and it will be refined in this context as it is refined in any other. Second, implication in fact is a considerable improvement upon implication by law because it focuses judicial attention on the right areas: the facts of the case; the words of the contract; and the intention of the parties. Further, it provides a context in which to define the duty of good faith. Third, it provides a platform on which to build, over time, through precedent and argument, a doctrine which does not suffer from these defects. The tests may or may not prove relevant to the implication of the duty of good faith – legal argument and judicial rationale will determine that. Finally, the advocated alternative, labelled 'construction', lacks substance and does not offer any of these advantages.

Exploring the alternative of 'construction'

Although Peden's opposition is strongest toward implication by law, she prefers that the existence of a duty of good faith be dealt with as a matter of construction rather than implication in fact.⁶⁶ Peden seeks to distinguish construction from implication in fact. To quote the faint praise of Sir Anthony Mason which introduces Peden's book, '[i]t is this elusive distinction that underlies [Peden's] approach. Whether the distinction is as sharp as the author contends may be open to question.'⁶⁷ As will emerge below, it is contended in this paper that the distinction is more imagined than real. However, it is clear that Peden considers that the construction approach to incorporating the duty of good faith into contract law is distinct from both implication in fact and implication in law – that it represents a third way – and it is discussed below on that basis.

In comparing construction and implication in fact, Peden recognises that '[t]he inference of the parties' intentions involved in construction and implication in fact are the same' and that '[t]he courts would merely be moving away from the use of tests of implication that have been shown to be lacking.'⁶⁸ In light of that, what would adopting construction achieve which implication in fact does not? If the tests of implication in fact are merely hollow vehicles for policy, moving to construction is simply a re-branding exercise. If the tests hold any value at

⁶³ Peden (2003), above n 3, 72-91.

⁶⁴ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 257-8.

⁶⁵ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 258.

⁶⁶ Peden (2001), above n 3, 230; Peden (2003), above n 3.

⁶⁷ Peden (2003), above n 3, Foreword (per Sir Anthony Mason). Sir Anthony Mason recognises the book's great value in other respects – in particular regarding the tests for implication in fact, the relationship between good faith and the duty of cooperation and the concept of good faith – but is noticeably elusive on the distinction between construction and implication in fact.

⁶⁸ Peden (2003), above n 3, 141.

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all, what is gained to compensate for removing them? All in all, would construction not – at best – be equally uncertain?

Peden's response to this question – which she poses herself – is unconvincing.⁶⁹ The uncertainty of construction eventually seems to be conceded, as Peden suggests that '[t]o the extent that the "business efficacy" and "obviousness" tests help courts discover and implement the parties' intentions, there is no reason why they could not be retained as tests of construction'.⁷⁰ This is recognition that tests of some nature may be necessary to constrain uncertainty. Peden turns to the very tests used in implication in fact. This undermines the argument for the use of construction as distinct from implication; indeed, it undermines the distinction between construction and implication. If in adopting construction the courts would 'merely be moving away from the use of tests of implication', reinstating those tests returns us to the point of departure. This is far from the initial assertion that 'implication in fact generally is rendered meaningless by construction'.⁷¹

The problem with the entire argument is the false dichotomy drawn between construction and implication in fact. In her conclusion, Peden notes that 'implication in fact is a rule of construction', and '[t]he tests of "business efficacy" and "obviousness" are guides to determining the intentions of the parties'.⁷² In contrast, construction as an independent doctrine does not have any identifiable substance of its own. Peden inadvertently demonstrates this in trying to show its lack of uncertainty in regard to the duty of good faith. As Peden states, 'implication in fact should be seen as part of construction...courts construe contracts to decide whether an implied term is needed or not'.⁷³ Implication in fact is a specific rule of construction. It is construction at work, in context, with content – 'an illustration of the process of construction', in the words of Mason J (as he then was).⁷⁴

Undoubtedly, there is an element of fiction to implication in fact. Peden rightly criticises the vagueness of the requirements for implication in fact and their use to obscure policy-based decision-making. There is no doubt that the law has less patience for fictions than in the past, and properly so; but time is of singular importance in the development of the common law. As Peden shows in the cases of frustration and anticipatory breach,⁷⁵ policy frequently breaks through from beneath the veneer of whatever fiction sheltered it to produce a common law

⁶⁹ Ibid, 144-5. Peden highlights the inevitability of marginal cases and the tension between certainty and justice, but these observations do nothing to absolve construction from being pure discretion. Peden then makes the solitary assertion that '[w]hile construction is a flexible tool, it provides predictability', but as support she cites Megaw LJ commenting on the importance of uniformity and predictability in the law. Peden falls back upon the existence of a number of canons of construction, but notes that these are merely devices for determining intention, as the requirements of good faith are, and that the excess of rules allows selective application. In addition, the existence of these rules of construction does nothing to justify the instancing of good faith as a rule of construction rather than implication in fact – they apply equally in either case. In the end, Peden concedes that the outcome will be left to judges, with an appeal to have faith in their 'informed and educated judgment, formulated in public discussion and founded not merely upon a shared experience of the practical administration of justice, but also upon an accepted basis of systematic legal principle'. This faith may be fairly invested, but it is faith in discretion – just as it is with implication in fact (taking a cynical view of the established tests).

⁷⁰ Ibid, 147.

⁷¹ Ibid, 141.

⁷² Ibid, 152.

⁷³ Ibid, 142.

⁷⁴ Ibid, 141.

⁷⁵ Ibid, 19-24.

rule independent of its origins.⁷⁶ Yet this extrication can only come when the weight of case law, the trial of time, glosses, analogies, special cases – in sum, precedent – provides a principled basis on which to proceed.⁷⁷ At this point, a ‘construction’ approach to the duty of good faith has no content of its own vis-à-vis an implication in fact approach. The construction approach is implication in fact.

The upshot from this is twofold. First, those looking to construction as a panacea for the ills of implication in fact should reconsider their focus. The construction argument is apt at identifying the problem, but it does not offer a solution. Second, and most importantly, the common goal – of good law, both rational and certain – is obtainable from the present position. Just as frustration and anticipatory breach have done, good faith can evolve from implication to become an integral, independent rule of the common law. While *Maitland* certainly does not cure the defects of implication in fact, the elements which should be important from a policy perspective are taken into account much more fairly. As a result, it is a positive step – a step on the road to clarity and transparency for the doctrine of good faith.

Conclusion

Without necessarily accepting that a duty of good faith ought to be implied into contracts, it seems clear that if such an implication is to be employed, it ought to be an implication in fact rather than by law. Employing implication in fact would allow a body of case law to develop which provides a reliable indication of the types of clauses into which a duty of good faith will be implied, and the content which that duty will be given.

Maitland, *Esso* and *City of Sydney* can be seen as examples of the implication in fact of a duty of good faith. There is enough authority, and enough confusion in existing authority – festering in the absence of a definitive consideration by the High Court – to allow implication in fact to be adopted by courts in the future. Implication in fact offers a practicable path for the implied duty of good faith.

⁷⁶ To posit a tipping point or critical mass: such a transition happens when the fiction does more to create uncertainty by obscuring the true policy factors informing the doctrine than it does to enhance certainty by rooting the doctrine in the intention of the parties (or other known, established concerns).

⁷⁷ This is reflected in the lack of uniformity between the doctrines which have moved away from implication in fact. There are no unifying features which make their characterisation as rules of construction revelatory in any way. Rather, they are independent rules of the common law, with their own content and operation, which have developed from a common basis in implication in fact. They may be rules of construction, but this is a grouping, not a commonality.