

April 2016

## Good Faith – The Gordian Knot of International Commerce

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### Recommended Citation

Bruno Zeller and Camilla Baasch Andersen, *Good Faith – The Gordian Knot of International Commerce*, 28 Pace Int'l L. Rev. 1 (2016)

Available at: <https://digitalcommons.pace.edu/pilr/vol28/iss1/1>

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# GOOD FAITH – THE GORDIAN KNOT OF INTERNATIONAL COMMERCE

**Bruno Zeller & Camilla Baasch Andersen\***

## INTRODUCTION

Good faith has long been one of “those” issues in an international context: one of the issues which represent a perplexing legal bee-hive of near unanswerable questions. The concept is perceived as the desperate argument of the losing lawyer in one jurisdiction, and the firmament of an established principle of fairness in another. Even within one jurisdiction it can represent a hotbed of uncertainty and unpredictability, and when applied across borders in international commerce, this problem is compounded.

Across the legal jurisdictions of the world, the term (or its multi-linguistic equivalences) has been debated at length and has either been included into domestic laws, or has been simply rejected as being too nebulous or not being able to be defined. It found its way into a host of civil law jurisdictions in different guises, and into the Uniform Commercial Code of the United States, but has only found a very unstable foot hold in English Common law, via European supranational legislation. In Australia good faith is an implied term and hence—unless specifically excluded—is applicable in all contractual relationships within the State legal systems, with no clarity on what this means.<sup>1</sup>

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<sup>1</sup> Unfortunately, the Australian High Court has not yet delivered an authoritative statement on the topic of good faith.

In short, there is no international consensus as to what the term embodies, or how it may be used to decide a case, in different legal jurisdictions.

However, the term also applies throughout a number of international instruments in commerce, such as the 1980 Convention of the International Sale of Goods (CISG) which is currently the applicable sales law for 83 states, including the USA and Australia, China and most major industrial nations (together representing over 75% of the world's trade). The impact of the CISG is seen even beyond its contracting states, and it is finding its way into the Courts of the UK, as an expression of international trade practices.<sup>2</sup> Its influence is significant, and growing.<sup>3</sup> Even countries which are not parties to the CISG are using its provisions as expressions of international trade practice.<sup>4</sup>

Article 7 of the CISG requires its provisions to be interpreted in the light of the need to regard good faith. The very same provision also requires regard to the "uniformity" of the convention as well as its "international character." It thus presupposes a uniform and international approach to good faith: Something which is, undeniably, an intractable problem, a true Gordian knot.

This paper does not attempt to cut this knot as Alexander the Great did with his legendary problem. Rather, it raises a number of questions which are due to some considerable discussion at an international level, involving the *scope* of the concept, and how to determine its *meaning*.

One of these issues for consideration is whether good faith has only one meaning or whether it is capable of being applied in various disguises depending whether it is used in a domestic

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<sup>2</sup> Institute of International Commercial Law, *CISG Database: Country Case Schedule – UK* (Apr. 14, 2015), <http://www.cisg.law.pace.edu/cisg/text/casecit.html#UK>.

<sup>3</sup> Francesco Mazzotta, *Good Faith Principle: Vexata Quaestio*, in *INTERNATIONAL SALES LAW, A GLOBAL CHALLENGE* 120 (Larry A. DiMatteo ed., 2014).

<sup>4</sup> For instance, there are three reported cases from the UK applying the CISG as trade practice indicator, see *ProForce Recruit Ltd. v. Rugby Group Ltd.* [2006] EWCA Civ. 69 (appeal taken from Eng.); *The Square Mile Partnership Ltd. v. Fitzmaurice McCall Ltd.* [2006] EWCA Civ. 1689 (appeal taken from Eng.); *Chartbrook Ltd. v. Persimmon Homes Ltd. et. al.* [2009] UKHL 38, [2009] 3 WLR 267 (H.L.) (appeal taken from Eng.).

setting or in an international one through the CISG. If that would be case potentially two different definitions of good faith would need to be applied. Andersen argued in a recent paper that good faith “is simply too tainted by regional diversity to be of any constructive use on a global transnational playing field.”<sup>5</sup> But many would balk at abandoning a concept which has served in one guise or another for more than 2000 years.

Moreover, it is important to keep in mind that good faith is part of the remedial system in cases of breaches of contractual terms. This is so as the law only recognises a wrong if it has already recognised a pre-existing duty.<sup>6</sup> The pre-existing duty is based on performance of contractual duties in good faith and “it is the ideal vehicle through which to introduce and incorporate the goals of ‘expansive equality’ into contract law.”<sup>7</sup> The relationship between good faith and approaches to contractual interpretation thus becomes significant.

In this context, Sepe argues that parties have an informational advantage over courts and hence know best when good faith serves efficiently.

What Sepe suggests is that parties only derive the desired *ex-ante* value of their relationship when the correct interpretative regime incorporating good faith is applied. That might be true but what good faith means or how it is applied has been left undefined.<sup>8</sup>

This paper argues that good faith cannot be defined and furthermore that there is no need to define good faith as it takes on meaning when applied to facts. Hence an explanation or application of good faith is defined by its function namely to enforce the expected performance of both parties. It is further argued that the function of good faith will determine which fact pattern has to be found by a court in order to determine the ex-

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<sup>5</sup> Camilla Andersen, *Good Faith? Good Grief? Festschrift for Bruno Zeller*, 17 INT'L TRADE AND BUS. L. REV. 310, 311 (2014).

<sup>6</sup> Justice James Edelman, *The Benefit of Legal Taxonomy*, 1 CURTIN L. AND TAX. REV. 1, 5-6 (2014).

<sup>7</sup> Emily Houh, *Critical Interventions: Towards an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law*, 88 CORNELL L. REV. 1025, 1033 (2002-2003) [hereinafter Houh, *Critical Interventions*].

<sup>8</sup> Simone M. Sepe, *Good Faith and Contract Interpretation: A Law and Economics Perspective* (Arizona Legal Studies Discussion Paper No. 10-28, 2010) 1, 6 [hereinafter Sepe, *Good Faith and Contract*].

pected performance of the contractual parties. It follows that good faith is the legal concept which allows courts to do justice and do it according to law. As good faith takes on meaning only when applied to contractual terms, Peden is correct to argue that “. . . the widespread use of ‘good faith’ in legislation is . . . completely unhelpful in the development of contractual good faith.”<sup>9</sup>

An interesting way to juxtaposition this point transnationally is to look at international and US theories of good faith in the light of the development of good faith in a jurisdiction which has struck a civil law/common law compromise about the use of the concept. Australia presents itself as a fledgling nation in the development of good faith, while simultaneously being a CISG state subject to the good faith of Art. 7. The paper will therefore examine the following:

The theoretical base on which a definition or explanation of the function of good faith is based is very divergent and will be discussed in part one. The conclusion which can be drawn from part one will be applied in part two to the most important available judicial decisions in determining whether there is consistency in the application of the concept. Part three will discuss whether the CISG and the domestic interpretative methods will influence the applications of good faith.

#### THE THEORETICAL BASE

It is not surprising that a definition of good faith proved to be frustratingly elusive despite that the concept of good faith appears to be easy to grasp as many terms in essence convey at least a similar duty. This is highlighted by the fact that a search reveals that the term good faith has been equated to: “unconscionability, fairness, fair conduct, reasonable standards of fair dealing, decency, reasonableness, decent behaviour, a common ethical sense, a spirit of solidarity, community standards of fairness” and “honesty in fact,”<sup>10</sup> the question is wheth-

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<sup>9</sup> Elisabeth Peden, *The Mistake of Looking for Legislative Influence in Contractual Good Faith*, 16(4) COMM. L.Q. 20 (2002).

<sup>10</sup> Troy Keily, *Good Faith and the Vienna Convention on Contracts for the International Sale of Goods (CISG)*, 3(1) VINDOBONA J. INT'L. COM. L. & ARB. 15 (1999).

er each of the terms describes the same phenomena namely good faith. This paper will not pursue this issue.

Furthermore, the examination has not only turned on what good faith means, but also what it covers. As an example, the UCC in article 1-203 states that good faith is required in both the performance and the enforcement of contracts. Professor Farnsworth also noted that the UCC uses the term good faith in two fundamentally different senses first as good faith purchase and secondly as performance and enforcement mechanism.<sup>11</sup> The scholarly or judicial interest in good faith generally has either focused on good faith performance or has assumed that the meaning of good faith in the performance, enforcement and good faith purchase must be the identical.<sup>12</sup> Andersen argued that this is not the case and that good faith warrants separate examination and development.<sup>13</sup> Andersen described the difference between performance and enforcement as follows:

Performance describes the benefits the receiving party primarily has bargained to receive from the other. The performance of a contract is what, at the time of contract formation the parties contemplated would satisfy the receiving party's purpose in entering the agreement. Performance is thus distinguished from enforcement, which consists of the means available to compensate for the unjustified absence of performance or to provide other incentives making performance more likely to occur.<sup>14</sup>

This paper recognises this fact. As a consequence this paper purposefully will focus the discussion only on good faith performance.

The starting point is to recognise that the implied terms of co-operation are not controversial even in English law. In *Mackay v. Dick*,<sup>15</sup> 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

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<sup>11</sup> Alan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U.CHI. L. REV. 666, 667-68 (1963).

<sup>12</sup> Eric Andersen, *Good Faith in the Enforcement of Contracts*, 73 IOWA L. REV. 299, 299 (1987-1988) [hereinafter Andersen, *Enforcement of Contracts*].

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 303-04.

<sup>15</sup> *Mackay v. Dick* [1881] 6 App. Cas. 251 (appeal taken from Eng.).

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.<sup>16</sup>

It is therefore not a great leap from the obligation to co-operate to include a term of good faith into a contract. In essence both terms attempt to achieve the same outcome namely to determine the required performance of both parties under a contract. As noted above already a discussion whether the term to co-operate or the term good faith are identical is not within the scope of this paper.

As far as good faith is concerned the seminal work undertaken by Professors Summers<sup>17</sup> and Burton<sup>18</sup> warrants close attention. Especially Summers is of importance as his theory was the basis in explaining the application of good faith in article 205 in the second *Restatement of Contract* which appeared in 1979 (and finally published in 1981).<sup>19</sup> Summers theory basically relies on the excluder principle. He explains that the expression “good faith” as commonly (and sometimes vaguely) used by judges is best understood as an “excluder”; that is, it “has no general meaning or meanings of its own, but . . . serves to exclude many heterogeneous forms of bad faith.”<sup>20</sup> Sepe summarised Summers’ arguments in favour of an open-ended conceptualisation of good faith in order to guarantee the substantive justice of contractual relations. Good faith imposes on

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<sup>16</sup> *Mackay*, 6 App. Cas. at 263.

<sup>17</sup> See Robert Summers, *The General Duty of Good Faith – Its Recognition and Conceptualisation*, 67(4) CORNELL L. REV. 810 (1982) [hereinafter Summers, *General Duty of Good Faith*]; Robert Summers, “*Good Faith*” in *General Contract Law and the Sales Provision of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968) [hereinafter Summers, “*Good Faith*” in *General Contract Law*].

<sup>18</sup> See Steven Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980) [hereinafter Burton, *Breach of Contract*]; Steven Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Law Code*, 67 IOWA L. REV. 1 (1981) [hereinafter Burton, *Article 2 of the Uniform Commercial Law Code*]; Steven Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497 (1984) [hereinafter Burton, *More on Good Faith Performance*].

<sup>19</sup> Summers, *General Duty of Good Faith*, *supra* note 17, at 810.

<sup>20</sup> Summers, “*Good Faith*” in *General Contract Law*, *supra* note 17, at 196, 262.

parties separate moral standards of conduct, which may override the explicit terms of the contract if these do not satisfy requirements of decency, fairness, or reasonableness.<sup>21</sup>

Summers argued that the conceptualisation of good faith as an excluder satisfies the relevant criteria of adequacy.<sup>22</sup> He also maintained that the excluder analysis has been first articulated by philosophers such as Aristotle and J.L. Austin.<sup>23</sup> Summers already realised that good faith has no meaning of its own. It is true to say that once all bad faith behaviour is excluded we are left with what could be termed good faith behaviour or any other term for that matter. However, the crucial point is what is bad faith? If something is to be excluded we need to know what it actually is. Summers left the question of how bad faith is discovered unanswered. The closest he came to define bad faith is to argue that it is the exclusion of contextually recognisable forms conducted in the performance of a given contract.<sup>24</sup>

A further problem with the analysis is that Summers includes concepts of morality, decency fairness, or reasonableness as being connected or part of good faith. The issue is that all the terms are in Summers implied view a reflection of good faith. As good faith is a fall-back position whether is synonymous with morality, decency or reasonableness is irrelevant. The central concern in Summers theory is that bad faith needs to be recognised and excluded.

Burton also rejected the excluder principle and by implication the comment in the *Restatement (Second)*. Burton observed that “[c]ourts generally do not use the good faith performance doctrine to override the agreement of the parties. Rather, the good faith performance doctrine is used to effectuate the intentions of the parties, to protect their reasonable expectations through interpretation and implication.”<sup>25</sup>

By implication, Burton recognised that if parties either exclude good faith or the intentions of the parties as expressed in the contract are clear good faith is not to be applied. This is so

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<sup>21</sup> Sepe, *Good Faith and Contract*, *supra* note 8, at 14.

<sup>22</sup> Summers, *General Duty of Good Faith*, *supra* note 17, at 821.

<sup>23</sup> *Id.* at 827.

<sup>24</sup> Houh, *Critical Interventions*, *supra* note 7, at 1036.

<sup>25</sup> Burton, *More on Good Faith Performance*, *supra* note 18, at 499.

as performance of the parties is contextually determinable. Good faith in essence is only required when the intentions and the performance are at odds with each other. Burton's attempt was to justify a forgone opportunity approach by suggesting that it will make it possible "to identify with greater particularity the relevant expectations and motives that have been held to constitute bad faith."<sup>26</sup> Burton notes that "[g]ood faith performance occurs when a party's discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation – to capture opportunities that were preserved upon entering the contract, interpreted objectively."<sup>27</sup>

Summers maintains that "such formulation provides very little, if any, genuine definitional guidance."<sup>28</sup> This criticism is not valid as Summers had argued that a definition of good faith is impossible and Burton never attempted to define good faith at all. By noting "good faith performance occurs" suggests that a path or a general tool is describing the capture of opportunities which are in the reasonable contemplation of the parties. In other words Burton attempts to maintain the equilibrium of contract expectations as they existed at the formation of the contract. Burton though distinguishes legitimate from illegitimate use of discretion and the good faith performance permits parties to exercise their discretion "for any purpose reasonably within the contemplation of the parties."<sup>29</sup>

Andersen, building on Burton's theory, suggests that good faith is the principle that controls the discretion a party enjoys in determining what constitutes proper performance<sup>30</sup> and that "the views of Professors Burton and Farnsworth coalesce to establish a concept of good faith in performance that, in effect, defines a category of permitted performance."<sup>31</sup> Andersen further noted:

Professor Farnsworth has argued that good faith in performance is linked to the implied terms that courts supply to fill gaps parties leave in agreements. He explains that such a gap – or *casus*

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<sup>26</sup> Burton, *Breach of Contract*, *supra* note 18, at 387.

<sup>27</sup> *Id.* at 373.

<sup>28</sup> Summers, *General Duty of Good Faith*, *supra* note 17, at 829.

<sup>29</sup> Burton, *Breach of Contract*, *supra* note 18, at 385-87.

<sup>30</sup> Andersen, *Enforcement of Contracts*, *supra* note 12, at 325.

<sup>31</sup> *Id.*

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*omissus* – may result either from the parties failure to foresee a set of circumstances that has arisen or from their decision not to address with express terms a particular set of circumstances that was foreseen.<sup>32</sup>

What can be said is that Professors Summers Burton and Farnsworth have highlighted the problems in discovering a possible application of good faith through its application. There is one point in the debate where especially Summers and Burton agree on namely that there is no general definition of good faith. However, there is also disagreement. Summers excluder principle was criticised because what bad faith actually is has not been defined. In other words what exactly are we to exclude has not been answered. Summers justifies this approach by arguing that good faith has no general meaning of its own therefore the meaning must be derived from an opposite that is bad faith.<sup>33</sup> There is authority which specifically rejects the “amorphous concept” of bad faith to determine whether good faith has been breached. The grounds on which the opinions are based are the difficulty to distinguish;

a bad faith discharge from no-cause discharge (which is permitted under the at-will doctrine) or a discharge in violation of public policy (which is not permitted) and on the further ground that a bad faith standard would require a judicial inquiry into the subjective intentions of the party who is alleged to have violated the covenant.<sup>34</sup>

Burton’s arguments, however, have also been criticised specifically; how do we find or understand what discretion in performance means? This is an important question as Professor Summers observed that Burton “seems content, for example to leave the general test of reasonableness of expectations relatively unanalysed”<sup>35</sup>

This criticism is very simply dismissed as a non-issue by looking at the claim of the aggrieved party which will set out

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<sup>32</sup> Andersen, *Enforcement of Contracts*, *supra* note 12, at 325.

<sup>33</sup> Summers, “*Good Faith*” in *General Contract Law*, *supra* note 17, at 201.

<sup>34</sup> 82 Am. Jur. 2d Wrongful Discharge § 69, quoting *Metcalf v. Inter-mountain Gas Co.*, 778 P.2d 744 (1989) and *Sorensen v. Comm Tek, Inc.*, 299 P.2d 70 (1990).

<sup>35</sup> Summers, *General Duty of Good Faith*, *supra* note 17, at 833.

what expectations are not met. The court only needs to determine whether the clause in question is either clear that there is no discretion allowable such as a set price for the goods or a clause requiring a subjective judgement on a party such “the goods must conform to an acceptable standard’.” Simply put the issue is reduced to a fact finding mission namely has the party in breach acted within the reasonable expectations of the parties if yes there is no breach of good faith. If the answer is no there is a breach hence the principle of good faith allows the court to act within the law and determine that a breach of an express term has occurred.

In sum this paper argues that both Burton and Summers have advanced our understanding of good faith in common law. Both correctly observed that good faith should and cannot be defined hence arguably the concentration ought to be on when and how good faith should be applied. To that end Burton’s theory of capturing the opportunities that were expected upon entering the contract is practical and deserves to be explored in the Australian context.

#### GOOD FAITH IN AUSTRALIA

It is undisputed that in Australia an implied duty to exercise good faith is well established at least within the state court systems despite the reluctance of the High court to speak on the matter. An attempt or discussion did take place in *Royal Botanic Gardens and Domain Trust v. South Sydney City Council*<sup>36</sup> but the question as to a recognition of good faith was left open. The court noted:

The second matter concerns the debate in various Australian authorities concerning the existence and content of an implied obligation or duty of good faith and fair dealing in contractual performance and the exercise of contractual rights and powers. It emerged in argument in this court that both sides accepted the existence of such an obligation False whilst the issues respecting the existence and scope of a “good faith” doctrine are important, this is an inappropriate occasion to consider them.<sup>37</sup>

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<sup>36</sup> *Royal Botanic Gardens and Domain Trust v. South Sydney City Council* [2002] 186 ALR 289 (Austl.).

<sup>37</sup> *Id.* at 301, ¶ 40.

Callinan J went even further by stating:

In view of the conclusion I have reached, it is unnecessary to answer the questions raised by the rather far-reaching contentions of the appellant, and for which, it says, *Alcatel Australia Ltd. v. Scarcella and Burger King Corp v. Hungry Jack's Pty. Ltd.* stand as authorities: whether both in performing obligations and exercising rights under a contract, all parties owe to one another a duty of good faith; and, the extent to which, if such were to be the law, a duty of good faith might deny a party an opportunistic or commercial exercise of an otherwise lawful commercial right.<sup>38</sup>

Callinan J in effect repeated the English view as to the principle of good faith despite the fact that the then Finn J who was on the working party for the preparation for the UNIDROIT Principles 2004 (and later on the 2010 edition) advocated the international position. Surprisingly Kirby J. took the same view. He commented that despite having the courts attention drawn to law both in this country and overseas as well as to academic commentary:

in Australia, such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include.<sup>39</sup>

As Callinan J so did Kirby J view the principle of good faith as being inconsistent with the concept of economic freedom. However, in *Farah Constructions Pty. Ltd. v. Say-Dee Pty. Ltd.*<sup>40</sup> the court indirectly ruled that an implied duty of good faith does exist. The court noted:

Intermediate appellate courts and trial judges in Australia should not depart from decisions in intermediate appellate courts in another jurisdiction on the interpretation of Commonwealth legislation or uniform national legislation unless they are convinced that the interpretation is plainly wrong. Since there is a common law of Australia rather than of each Australian jurisdic-

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<sup>38</sup> *Id.* at 327, ¶ 156.

<sup>39</sup> *Royal Botanic Gardens and Domain Tr.*, 186 ALR at 312, ¶ 87-88.

<sup>40</sup> *Farah Constructions. Pty. Ltd. v. Say-Dee Pty. Ltd.* [2007] 230 CLR 89 (Austl.).

tion, the same principle applies in relation to non-statutory law.<sup>41</sup>

The High Court might have left the door slightly ajar but not sufficiently in order to admit good faith. Academic views are mixed<sup>42</sup> and reservations are also expressed such as Peden who argued:

[G]ood faith in the performance of contracts is one of those annoying areas of law that keeps appearing in cases, and yet even with decisions from appeal courts, we seem no closer to a resolution of exactly when an obligation of good faith in the performance of contracts will be incorporated, and exactly what that obligation will impose.<sup>43</sup>

Peden did pose the questions which arguably have been addressed by Summers, Burton and Farnsworth. Their views appear to emanate from well-established legal principles identified in fragments of Burton's theory, and other scholarly judgments and views. As an example, the identification of types of contracts in *Tote Tasmania Pty. Ltd. v. Garrott*<sup>44</sup> contains elements of Burton's theory. The court noted:

One is a provision conferring a power in an agreement, such as a partnership agreement, which is concerned with co-operation between the parties to produce a result which benefits all the parties to the contract. In such an agreement, a court might readily imply an obligation to act in good faith in that the party upon whom the power is conferred must have regard to the interest of all the parties to the agreement. Another type of provision is one which confers a power if the donee of the power considers that a certain state of affairs or conditions exists. In such a case, a court may well hold that the power can only be exercised by an honest decision that the state of affairs or condition does exist, but the honest exercise of the power will not be reviewed by the court. Another type of provision is one conferring a power that is quite unqualified. In such a case, a court may conclude that the power can legitimately be exercised in the interests of the party upon whom it is conferred and that party is to be the sole judge of

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<sup>41</sup> *Id.* at 135.

<sup>42</sup> See Bruno Zeller, *Good Faith: Is it a Contractual Obligation?*, 15(2) BOND L. REV. 217 (2003) (providing a positive view with respect to its consideration of international law).

<sup>43</sup> Elisabeth Peden, *Good Faith in the Performance of Contract Law*, 42(9) LAW SOC'Y J. 64, 64 (2004).

<sup>44</sup> *Tote Tasmania Pty. Ltd. v. Garrott* [2008] 17 Tas R 320 (Austl.).

where its interests lie and may exercise [*sic*] the power for any reason it sees fit.<sup>45</sup>

Burton in essence – as noted above – indicated the same principle when he stated:

“Courts generally do not use the good faith performance doctrine to override the agreement of the parties. Rather, the good faith performance doctrine is used to effectuate the intentions of the parties, to protect their reasonable expectations though interpretation and implication.”<sup>46</sup>The question as to the utility of good faith is whether it delivers certainty in business dealings. The Honourable Marilyn Warren made the following suggestion, arguably agreeing with Burton’s views:

. . . [I]t must be acknowledged that good faith as a doctrine does not exist independently of the rules surrounding the construction and interpretation of contracts, or the rules of implication. Whilst the process of contractual interpretation is distinct from the process of implying terms into a contract, it can sometimes be difficult to separate the two. This is particularly so with regard to good faith, which appears to be obscured by what may be a merging of the two processes (interpretation and implication) in the arena of good faith.<sup>47</sup>

The importance of applying good faith is to recognise that it is a principle which derives its authority only in circumstances where the interpretation and construction of contracts leads the courts to find that a party did not act within the reasonable expectations of the parties. Only after the interpretative process is finished, can good faith be applied. Farnworth argued (as noted above) that good faith in performance is linked to the implied terms that courts supply to fill gaps the parties have left in the agreements. “A term will be implied in law in circumstances where the implication of a particular term (usually an obligation) is necessary to prevent the enjoyment of the rights conferred by the contract from being ‘rendered nugatory, worthless or, perhaps, [being] seriously undermined.’”<sup>48</sup>

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<sup>45</sup> *Id.* at 322.

<sup>46</sup> Burton, *More on Good Faith Performance*, *supra* note 18, at 499.

<sup>47</sup> The Hon. Marilyn Warren AC, *Good Faith: Where Are We At?*, 34 MELB. U. L. REV. 344, 349 (2010).

<sup>48</sup> *Id.* at 351, *citing* *Byrne v. Australian Airlines Ltd.* [1995] 185 CLR

The boundary between interpretation and implication is not always clear and “it may be that interpretation, to some degree, shades into implication.”<sup>49</sup> The point was made that after all “that ‘[i]f good faith is not readily capable of definition then [contractual] certainty is undermined’, and that the duty to act reasonably may properly be subsumed within the duty of good faith.”<sup>50</sup>

It is submitted that Burton’s theory—and Summers’ for that matter—has been greatly undervalued and an examination of the facts and comments of Australian jurisprudence requires a closer examination.

The beginning of the debate can be traced back to 1992 in *Renard Constructions (ME) Pty. Ltd. v. Minister for Public Works*.<sup>51</sup> The court and in particular Priestley, JA noted:

The kind of reasonableness I have been discussing seems to me to have much in common with the notions of good faith which are regarded in many of the civil law systems of Europe and in all States in the United States as necessarily implied in many kinds of contract. Although this implication has not yet been accepted to the same extent in Australia as part of judge-made Australian contract law, there are many indications that the time may be fast approaching when the idea, long recognised as implicit in many of the orthodox techniques of solving contractual disputes, will gain explicit recognition in the same way as it has in Europe and in the United States.<sup>52</sup>

However, Summers’ views did resonate in Australia and Priestley, J, in *Renard Constructions*, did think that Summers’ approach has the great merit of being workable, without involving the use of fictions often resorted to by courts where the good faith obligation is not available, and reflects what actually happens in decision making. I think Summers was quite accurate when he said “. . . [T]he typical judge who uses this phrase

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410, 450 (McHugh and Gummow JJ) (Austl.), citing Glanville Williams, *Language and the Law — IV*, 61 L. Q. REV. 384, 401 (1945).

<sup>49</sup> Warren, *Good Faith: Where Are We At?*, supra note 47, 34 MELB. U. L. REV. at 355.

<sup>50</sup> *Id.* at 355-56, quoting *Esso Austl. Resources v. S. Pac. Petroleum* [2005] VSCA 228, [3] (Austl.).

<sup>51</sup> *Renard Constructions (ME) Pty. Ltd. v. Minister for Public Works* [1992] 26 NSWLR 234 (Austl.).

<sup>52</sup> *Id.* at 263-64.

is primarily concerned with ruling out specific conduct, and only secondarily, or not at all, with formulating the positive content of a standard.”<sup>53</sup>

As discussed above the criticism of Summers’ excluder theory is that he never explained nor defined bad faith. Courts in Australia have occupied themselves with this question by addressing the issue of bad faith. Notably Sheller JA<sup>54</sup> quoting Kelly J<sup>55</sup> stated:

In most cases, bad faith can be said to occur when one party, without reasonable justification, acts in relation to the contracts in a manner where the result would be to substantially nullify the bargained objective or benefit contracted for by the other, or to cause significant harm to the other, contrary to the original purpose and expectation of the parties.<sup>56</sup>

Sheller JA in effect alludes to the fact that once the original purpose and expectations of parties is discovered any deviation can be termed bad faith. Arguably he does not use the excluder principle as advocated by Summers. Good faith by implication demands that parties cannot nullify the bargained objectives of the contract. Sir Anthony Mason similarly noted “I use good faith mainly in the sense of loyalty to the promise itself and as excluding bad faith behaviour”<sup>57</sup> Kirby J<sup>58</sup> in effect stated correctly that good faith behaviour can be determined through objective interferences taken from evidence, and that good faith means more than the absence of bad faith. Arguably Summers’ argument is a back to front analysis as good faith becomes the default position by excluding bad faith. This seemingly rejects Summers’ theory by implication as being unworkable in Australia.

If one were to accept Burton’s theory, namely situations where a party has *discretion to perform* and would have to be *interpreted objectively*, the crux of the issue is what interpreta-

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<sup>53</sup> *Id.* at 267.

<sup>54</sup> *Alcatel Austl. Ltd. v. Scarcella & Ors.* [1998] 44 NSWLR 349 (Austl.).

<sup>55</sup> *Gateway Realty Ltd. v. Arton Holdings Ltd. (No 3)* [1991] 106 NSR (2d) 180 (Austl.).

<sup>56</sup> *Id.* at 197.

<sup>57</sup> Sir Anthony Mason, *Contract, Good Faith and Equitable Standards in Fair Dealing*, 116 L.Q. REV. 69 (2000).

<sup>58</sup> *Canane v. J Canane Pty. Ltd.* [1998] 192 CLR 557 (Austl.).

tive tool is to be used.

Two issues really need to occupy the courts namely was there a discretion to perform and secondly was that discretion used to capture the opportunities which are within the reasonable contemplation of the parties. It is therefore useful to investigate whether the leading Australian cases on good faith did in essence deal with discretion to perform as argued by Burton.

In *Alcatel Australia Ltd. v. Scarsella & Others*<sup>59</sup> the issue was how the terms of the lease were to be constructed. For the purpose of this paper it is sufficient to look at clause 2(c)(i) which stated:

That the Lessee will during the said term well and substantially repair and keep in good and substantial repair the demised premises and all appurtenances thereto belonging and all additions thereto and the boundary walls and fences thereof and all sewers and drains soil and other pipes and sanitary and water apparatus.<sup>60</sup>

Arguably the terms reflect sufficiently the situation where one party has discretion to perform. Of interest is that the court noted:

Moreover, the common law imposes a duty on the parties to a contract to co-operate in achieving the objects of the contract: Sir Anthony Mason said that such cases come close to a recognition of the good faith doctrine described as "loyalty to the promise itself." But such an obligation cannot over-ride the express provisions of the contract. If a contract confers power on a contracting party in terms wider than necessary for the protection of the legitimate interests of that party, the courts may interpret the power as not extending to the action proposed by the party in whom the power is vested or, alternatively, conclude that the powers are being exercised in a capricious or arbitrary manner or for an extraneous purpose, which is another way of saying the same thing.<sup>61</sup>

It can be argued that *Alcatel* in essence followed Burtons theory and applied the implied duty of good faith to a situation where good faith needs to be applied. Sheller JA in his judg-

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<sup>59</sup> *Alcatel Austl. Ltd.*, 44 NSWLR at 349.

<sup>60</sup> *Id.* at 351.

<sup>61</sup> *Id.* at 368.

ment referred not only to *Renard Construction* but also to the relevant sections of the UCC and concluded that a duty of good faith, both in performing obligations and exercising rights may, by implication, be imposed upon parties as part of a contract.<sup>62</sup>

Finn J in *Hughes Aircraft v. Airservices Aust.*<sup>63</sup> was confronted with the question whether the tender process was conducted in a fair and equitable manner. Words such as “a process that is fair to both Companies” were used which arguably inferred that the process was conducted in good faith. In this case the discretionary aspect as described by Burton is not apparent. The issue was as the court noted:

If the purpose of a tender process contract is to be accomplished, if contract-tenderers are to be given an effective opportunity to enjoy the fruits of their bids, and not to have that opportunity destroyed by the unfair dealing of the other party to the contract, the duty to deal fairly is a presupposition of such a contract.<sup>64</sup>

Finn J – after noting international sources on good faith – concluded that

It[']s more open recognition in our own contract law is now warranted . . . I should add that, unlike Gummow I consider a virtue of the implied duty to be that it expresses in a generalisation of universal application, the standard of conduct to which all contracting parties are to be expected to adhere throughout the lives of their contracts.<sup>65</sup>

However, Finn J did not define nor indicate what good faith actually means and arguably simply relied on *Renard Construction* as having introduced the term of good faith as an implied duty into all contracts.

In *Burger King*<sup>66</sup> the issue turned on cl 4.1.(a) and cl 4.2 where the granting of operational, financial and legal approval is within “the sole discretion” of Burger King Corporation. If full force is given to that concept, it would allow Burger King Corporation to give or to withhold relevant approval “at its

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<sup>62</sup> *Id.* at 349.

<sup>63</sup> *Hughes Aircraft v. Airservs. Austl.* [1997] 76 FCR 151 (Austl.).

<sup>64</sup> *Id.* at 154.

<sup>65</sup> *Id.* at 192-193.

<sup>66</sup> *Burger King Corp. v. Hungry Jack's Pty. Ltd.* [2001] 69 NSWCA 558 (Austl.).

whim.”<sup>67</sup> It is clear that the facts fall within the ones promulgated by Burton. The court held in point 3 of the judgment:

Such terms are implied, not to restrict a party to a contract acting so as to promote its own legitimate interests that are consistent with the explicit terms of the agreement, but so that the other party’s enjoyment of the rights conferred by the contract would not or could not be rendered nugatory, worthless or perhaps seriously undermined.<sup>68</sup>

However, referring to Priestley JA in *Renard Constructions* the court did in fact mention the excluder theory of Summers as well to the UCC and the Restatement Second and hence accepted the existence of good faith in Australian jurisprudence.<sup>69</sup> Furthermore like in *Renard Constructions* the court noted that Australian cases make no distinction of substance between the implied term of reasonableness and that of good faith. Unsurprisingly the same view was expressed in *Alcatel* where Sheller JA was also giving the judgement.<sup>70</sup> This paper will not pursue the point whether there is in fact a difference between the two terms but accepts the view as expressed in *Burger King* and *Alcatel*. In relation to the meaning of good faith the court followed the principle as expressed in *Renard Constructions*.

It can be argued that the court - despite the fact relying on the excluder theory as expressed by Priestley JA - did in fact follow Burton’s principle without actually noting it expressly. It indicates that Burton arguably observed common fact patterns and constructed his theory around facts which have been linked to reasonableness and of course good faith.

What can be observed is that Australian jurisprudence is consistent in applying good faith but without having settled on a sound theoretical base as supplied by Burton. Recently the New South Wales Supreme Court had cause to apply good faith.<sup>71</sup>

At issue was whether the Commonwealth was entitled to evict

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<sup>67</sup> *Id.* at 571.

<sup>68</sup> *Burger King Corp.*, 69 NSWCA at 558.

<sup>69</sup> *Id.* at 566.

<sup>70</sup> *Alcatel Austl. Ltd.*, *supra* note 54, 44 NSWLR at 369.

<sup>71</sup> *NSW Rifle Assn. Inc. v. Commonwealth* [2012] ALR 158 (Austl.).

the plaintiff from the rifle range and associated buildings, and whether the Commonwealth could transfer part of the Malabar Headland to the state for use as a national park. The Commonwealth purported to evict the plaintiff relying on its power to terminate the contractual license and the doctrine of executive necessity.<sup>72</sup>

White J following the lead of Finn J in *Hughes Aircraft Systems International* noted: “The fact that the contract is with the government does not displace an obligation of good faith and reasonableness. If anything, that is a factor in favour of the implication of the term.”<sup>73</sup> Of importance is that the term of good faith is now well established as a matter of law and not fact. This is not to say that it cannot be incorporated as a matter of fact but the difficulties of such an implication far outweighs if good faith is implied as a matter of law. White did note the difference and referring to jurisprudence that:

... there also appeared to be increasing acceptance of the proposition (which they thought to be correct) that, if terms of good faith and reasonableness are to be implied, they are to be implied as a matter of law. The preference for implication as a matter of law is, no doubt, due to the difficulty of complying with the criteria for an implication in fact enunciated in *BP Refinery (Westernport) Pty. Ltd. v. Hastings Shire Council* (1977) 180 CLR 266.<sup>74</sup>

Arguably the case turned on the fact whether good faith provides the principle basis to remedy the situation where insistence on the prima facie contractual right would be unconscionable. In essence Burton’s thesis again is applicable more so than Summers. A clear indication to that end is expressed in *Macquarie International Health Clinic Pty. Ltd. v. Sydney South West Area Health Service*<sup>75</sup> quoted by White J:

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

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<sup>72</sup> *Id.* at 158.

<sup>73</sup> *NSW Rifle Assn. Inc.*, [2012] ALR at 180.

<sup>74</sup> *Id.* at 181.

<sup>75</sup> *Macquarie Int’l Health Clinic Pty. Ltd. v. Sydney S.W. Area Health Serv.* [2010] 15 BPR 28, 563; [2010] NSWCA 268 (Austl.).

both parties.<sup>76</sup>

Of significance is the view of White J that the "term [of good faith] is so obvious as to go without saying"<sup>77</sup> and to give efficacy to the intended relationship between the parties.<sup>78</sup> The point is that the relationship and hence the application of good faith is not restricted to business dealings or any branch of contract law but in general to all dealing between parties founded on a contractual basis. It is in stark contrast to the views expressed in England.

It is of interest to note that in *BP Refinery (Westernport) Pty. Ltd. v. Hastings Shire Council (BP Refinery)*<sup>79</sup> it was held by Viscount Dilhorne, Lord Simon of Glaisdale and Lord Keith of Kinkel, Lord Wilberforce and Lord Morris of Borth-y-Gest dissenting, that:

In order to justify the implication of a term in a contract which the parties have not thought fit to express, the following conditions (which may overlap) must be satisfied: (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; (5) it must not contradict any express terms of the contract.<sup>80</sup>

Arguably the above statement is very close if not replicated in Burton's theory as noted above, but repeated here for ease of comparison. "Good faith performance occurs when a party's discretion is exercised for the purpose within the reasonable contemplation of the parties at the time of formation – to capture opportunities that were preserved upon entering the contract, interpreted objectively."<sup>81</sup> All the criteria qualifying the implication as a term of law as expressed in *BP Refinery* are also contained in Burton's theory except the words 'good faith.'

The treatment of good faith in Australia is in stark con-

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<sup>76</sup> *Id.* at 147.

<sup>77</sup> *Id.* at 184.

<sup>78</sup> *Id.*

<sup>79</sup> *BP Refinery (Westernport) Pty. Ltd. v. Hastings Shire Council* (1977) 180 CLR 266 (Austl.).

<sup>80</sup> *Id.* CLR at 267.

<sup>81</sup> Burton, *Article 2 of the Uniform Commercial Law Code*, *supra* note 18, at 373.

trast to English law. It appears that as soon as good faith is mentioned in English law, instead of focusing on the issues of implication of terms focused on good faith. As an example, in *Walford v. Miles*<sup>82</sup> good faith was dismissed as being inherently repugnant to the adversarial position of the parties when involved in negotiations . . . [and] unworkable in practice.<sup>83</sup> Importantly Australia has recognised that implications of law are to be preferred over an implication of fact. It appears that English law has not reached that point yet.

In *Yam Seng Pty. Ltd. v. International Trade Ltd.*,<sup>84</sup> Leggatt J. addressed the issue of an application of good faith by stating first that “refusing, however, if indeed it does refuse, to recognise any such general obligation of good faith, this jurisdiction would appear to be swimming against the tide.”<sup>85</sup> But he went on to explain that:

I doubt that English law has reached the stage, however, where it is ready to recognise a requirement of good faith as a duty implied by law, even as a default rule, into all commercial contracts. Nevertheless, there seems to me to be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties.<sup>86</sup>

As *Yam Seng* pleaded a breach of an implied term of good faith the court had to address the issue. Leggatt J, approached the submission by the claimant by noting that he will address a breach of an implied term in fact. Arguably he equated good faith to a factual event and hence avoided the issue of defining good faith a very good example of legal gymnastics. In essence he avoided a definitional issue by relegating it to a factual one. “This technique gives judges discretion to examine the issue on a case-to-case base.”<sup>87</sup> However, Leggatt J. went on to argue that:

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<sup>82</sup> *Walford v. Miles* [1992] 2 AC 128 (H.L.) (appeal taken from Eng.).

<sup>83</sup> *Walford*, 2 AC at 138.

<sup>84</sup> *Yam Seng Pty. Ltd. v. Int’l Trade Ltd.* [2013] EWHC 111 (QB) (appeal taken from Eng.).

<sup>85</sup> *Id.* at ¶ 124.

<sup>86</sup> *Yam Seng Pty. Ltd.*, [2013] EWHC at ¶ 131.

<sup>87</sup> Qi Zhou, *The Yam Seng Case: A New Development of Good Faith in English Contract Law*, XVII INT’L TRADE AND BUS. L. REV.358, 362 (2014).

A paradigm example of a general norm which underlies almost all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically on trust . . . [and] the implication of an obligation of good faith is heavily dependent on the context.<sup>88</sup>

Arguably therefore expectation of honesty was taken to either replace the term of good faith or it was thought to be an interchangeable term. This is based on the courts observation that the respondent owed two implied duties namely an expectation of honesty and observance of the standards of commercial dealings.<sup>89</sup> Furthermore as Leggatt J. treated the issue as a breach of an implied term in fact he noted that he can only do so if first the term implied is so obvious it goes without saying and secondly the term is necessary to give business efficacy to the contract.<sup>90</sup> Of interest is that the judgment of Leggatt J generated extensive debate and has been noted in several cases.<sup>91</sup>

Considering that *BP Refinery* used the same justification when implying terms as a matter of law as did Leggatt J who noted that good faith can only be implied as a matter of fact the question must be asked is there a difference between implied law and implied fact. Obviously comparing the two judgements there is none and it can be argued that Leggatt J merely tried to avoid creating a new precedent once the word good faith appears as a term in a contract.

It follows that implied terms however they are phrased which includes good faith are treated in the same fashion. What remains to be determined is whether Burton's theory noting in brief that good faith is only applicable if a party's discretion is exercised to capture opportunities that were preserved upon entering the contract is different than the one noted in *BP Refinery* and by Leggatt J. In Australia, White J in *NSW*

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<sup>88</sup> *Yam Seng Pty. Ltd.*, [2013] EWHC at ¶¶ 135, 147.

<sup>89</sup> Zhou, *supra* note 87, at 364.

<sup>90</sup> *Id.* at 362.

<sup>91</sup> See *Bristol Groundschool Limited v. Whittingham* [2014] EWHC 2145 (appeal taken from Eng.); *Greenclose Ltd. v. National Westminster Bank plc* [2014] EWHC 1156 (Ch) (appeal taken from Eng.); *TSG Building Services plc v. S. Anglia Housing Ltd.* [2013] EWHC 1151 (TCC) appeal taken from Eng.; *Mid Essex Hospital Services NHS Trust v. Compass Group UK and Ireland Ltd. (Trading As Medirest)* [2013] EWCA Civ. 200 (appeal taken from Eng.).

*Rifle Association Inc. v. Commonwealth* gave a clear indication that good faith relies on the same principles as propounded in *BP Refinery*.

One fact is clear neither Australian jurisprudence nor Burton attempt to define what good faith means. Good faith is simply a mechanical tool to interpret contracts and give meaning to the intention of the parties. *BP Refinery* contemplated five conditions to justify the implication of a term.

First “it must not contradict any express terms of the contract.” Burton equally notes that only terms which allow a party discretion to perform is subject to a good faith interpretation. Secondly “it must be reasonable and equitable.” The counterpart is the fact that Burton notes that the legitimate interests of both parties as determined at the formation of the contract will be enforced. Thirdly “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.” Business efficacy is implied in Burton’s theory in the endeavour to objectively interpret terms in order to give force to the expectations of the parties. Furthermore the fact that a term must be interpreted is the result that the contract otherwise would not be effective. Fourth it must be so obvious that “it goes without saying.” Burton does not expressly address this point however by noting that a term gives discretion to one party in their performance it can be argued that to give force to the term goes without saying. Lastly *BP Refinery* notes that an implied term must be capable of clear expression.

Arguably the term of good faith is not capable of clear expression as it is not able to be clearly and uniformly defined. However the term of good faith is recognised in Australia as precedent and has been implied into contracts and hence the function of good faith has a base despite not having been clearly defined. The point is that good faith is a functional principle and derives its purpose and application from a factual background and hence can be applied without having a clear definition. The Hon Marilyn Warren correctly noted that “in all our dealings, the commercial purpose test should be a fundamental consideration. On this, there is a clear mandate from the High Court. Respect for it will, in most cases, lead to the most appropriate good faith outcome achievable in any particular

case.”<sup>92</sup>

Comparing domestic and international legal documents containing the mandate of good faith the functional approach does pose problems. The issue is that a functional approach requires an application of facts. Considering that Australian sales law consists of common law and the CISG both containing a mandate to interpret contracts with good faith a difference in application is possible. This will happen even if the functional approach will be adopted by both of the sales law as they employ different tools to extract permissible facts which are informing the court in their decision making.

#### THE INTERPRETATIVE FRAMEWORK

This part is by no means exhaustive and the purpose is to merely touch on the problem of interpretation and its effect on the application of good faith. The common law and the CISG employ different interpretative tools hence affecting the admissible facts.<sup>93</sup> It must be stated that the starting point of both systems is different. The common law adheres to the objective approach whereas the CISG in article 8(1) starts with the subjective approach in the interpretation of contracts.

In Common law the parol evidence rule is used but the issue between the advocates of the textual approach and contextual approach has not been completely resolved. Advocates of the textual approach to interpretation would suggest that good faith injects uncertainty into legal relationships and hence a very restrictive view is taken. According to this view it should be limited to a prohibition of intentional dishonesty only and not to modify explicit contractual terms or restrict powers attributed by contract.<sup>94</sup> The contextual approach on the other end of the spectrum attempts to guarantee the substantive justice of contractual relations (specifically in the U.S) by using good faith to incorporate equitable standards of fairness and decency into a contract which might depart from express con-

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<sup>92</sup> Warren, *supra* note 47, at 357.

<sup>93</sup> See generally Bruno Zeller, *The Parol Evidence Rule and the CISG – A Comparative Analysis*, 36(3) COMP. INT'L L. J. S. AFR. 308 (2003).

<sup>94</sup> Sepe, *supra* note 8, at 3.

tractual provisions.<sup>95</sup> The issue is whether under a good faith interpretative regime a court is obliged to abide by express terms and can only determine its own discretion when good faith is applied in relation to incompleteness in a contract and hence prevent opportunistic behaviour.

In domestic Australian contracts in *Western Export Services Inc and Others v. Jireh International Pty. Ltd*<sup>96</sup> the High Court rejected a contextual interpretation and noted that:

Acceptance of the applicant's submission clearly would require reconsideration by this court of what was said in *Codelfa Construction Pty. Ltd. v. State Rail Authority (NSW)* by Mason J, with the concurrence of Stephen and Wilson JJ, to be the "true rule" as to the admission of evidence of surrounding circumstances. Until this court embarks upon that exercise and disapproves or revises what was said in *Codelfa*, intermediate appellate courts are bound to follow that precedent. The same is true of primary judges, notwithstanding what may appear to have been said by intermediate appellate courts.<sup>97</sup>

It is argued that following the rule as laid down by *Codelfa*<sup>98</sup> a true understanding of good faith is impeded as only surrounding circumstance will in many cases reveal the intent of the parties and they are explicitly excluded. However recent developments have softened the approach to the interpretation of statutes and hence contractual texts in general. Kirby seems to agree with the contextual approach noting that: that "the interpretation of contracts is concerned as such with discovering the subjective intentions of writers of the words in question."<sup>99</sup> He went further arguing in *Agricultural and Rural Finance Pty. Ltd. v. Gardiner and Another*<sup>100</sup> as the dissenting judge: "I would not accept this conclusion as stating an absolute rule. I do not agree that later communications and conduct of parties

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<sup>95</sup> *Id.* at 4.

<sup>96</sup> *W. Export Servs. Inc. & Ors. v. Jireh Int'l Pty. Ltd.* [2011] HCA 45 (Austl.).

<sup>97</sup> *Id.* at ¶ 3.

<sup>98</sup> *Codelfa Constr. Pty. Ltd. v. State Rail Authority* [1982] (NSW) 149 CLR 337 (Austl.).

<sup>99</sup> Michael Kirby, *Towards a Grand Theory of Interpretation: The Case of Statutes and Contracts*, 24(2) STATUTE L. REV. 95, 98 (2003).

<sup>100</sup> *Agric. & Rural Fin. Pty. Ltd. v. Gardiner & Ano.* [2008] HCA 57 (Austl.).

to an agreement are inadmissible when tendered to indicate acceptance by the parties of a particular meaning of the language used in their agreement.”<sup>101</sup>

Kirby J specifically argues in relation to the admissibility of post contractual conduct. However the question is why is pre-contractual conduct not included in his argument? After all the true beginning of a construction of words and their meaning commences at the pre-contractual period, then progresses possibly to a written statement and is followed by post contractual conduct.

Turning to the CISG article 8 provides rules for the interpretation of an agreement based on the statements and the conduct of the parties. Both the subjective as well as objective intent may be relevant. Importantly article 8(1) set out the subjective intent first. The key criterion is that both parties either knew or could not have been unaware what the intent was. Only if the subjective intent does not yield any result will the court revert to the objective intent of the parties. The CISG prescribes the reasonable person test as well as the intent of the parties which is defined in article 8(3). Furthermore this article also notes what circumstances can be taken into consideration when determining the intent of the parties or the reasonable person. These include “the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.”<sup>102</sup>

It is argued that Burton – inadvertently perhaps – allowed pre-contractual conduct to be taken into consideration when determining the intent of the parties. Burton noted that good faith performance occurs when a party’s discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation [of the contract].<sup>103</sup> It goes without saying that the formation stage is heavily influenced what the parties know or ought to have known and hence pre-contractual conduct ought to be taken into consideration in order to fully appreciate Burton’s theory. The CISG has done that

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<sup>101</sup> *Id.*

<sup>102</sup> Convention on Contracts for the International Sale of Goods, Jan. 1, 1988, 149 U.N.T.S. 3, art. 8(3).

<sup>103</sup> Burton, *Article 2 of the Uniform Commercial Law Code*, *supra* note 18, at 373.

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in article 8.

The contrary argument is that the written contract reflects the contemplation of the parties and hence the parol evidence rules specifically the contextual approach will enable the court to understand what was in the minds of the parties. The problem is that the courts will not take the intentions of the parties in their pre-contractual discussions into consideration. The difference between the CISG and common law is best illustrated by a CISG case which was applied in the U.S. In *MCC-Marble Ceramic Center v. Ceramica Nuova D'Agostino*<sup>104</sup> the issue was whether the parol evidence rule of domestic law applies to the interpretation of a contract governed by CISG.

A U.S. retailer, the buyer, agreed orally with the seller, an Italian manufacturer of ceramic tiles, on the basic terms for the purchase of tiles. The parties then recorded these terms in the seller's standard, pre-printed order form and the president of the buyer's company signed the form on behalf of the company. The form was printed in the Italian language and contained terms on both the front and back. The buyer presented affidavits from its president and two employees of the seller stating that the parties did not intend to be bound by the standard terms on the order form.<sup>105</sup>

Balancing the U.S. parol evidence rule against CISG Article 8, the court stated:

[A]rticle 8(3) of the CISG expressly directs courts to give 'due consideration . . . to all relevant circumstances of the case including the negotiations . . . ' to determine the intent of the parties. Given article 8(1)'s directive to use the intent of the parties to interpret their statements and conduct, article 8(3) is a clear instruction to admit and consider parol evidence regarding the negotiations to the extent they reveal the parties' subjective intent. . . .<sup>106</sup>

Of note is the fact that the District Court for the Southern District of Florida excluded evidence on the basis of the domestic parol evidence rule whereas the Federal Appellate Court correctly noted the homeward trend and reversed the judg-

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<sup>104</sup> *MCC-Marble Ceramic Center v. Ceramica Nuova D'Agostino*, 144 F.3d 1384 (11<sup>th</sup> Cir. 1998).

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

ment.

### CONCLUSION

It has been argued that a definition of good faith is elusive. This paper argues that while this may be correct, it is not wholly relevant, as theory and jurisprudence indicate that a definition is simply not needed. Both Burton and Summers have purposefully not attempted to define good faith. Burton specifically has changed the focus of attention away from an endeavour to find a definition of good faith to define a fact pattern where good faith is the principle of law. Both authors have demonstrated that good faith can only be applied if there is a factual pattern. Specifically Burton noted that good faith is required when a party's discretion is exercised for any purpose which is not within the reasonable contemplation of the parties at the time of formation. This principle is needed to – repeating Summers words - “do justice and do it according to law.”<sup>107</sup>

The analysis of Australian jurisprudence as an example of a nation developing its relationship to good faith shows that it is possible to reach the same conclusion as Burton and Summers with the use of an implied duty of good faith but without a solid theoretical base.

This paper has also highlighted that good faith outcomes are not necessarily identical even given the same factual patterns as the interpretational tools vary between Australian domestic and international sales contracts as seen in *MCC-Marble*. To that end Andersen may have been (mostly) correct in noting that good faith “is simply too tainted by regional diversity to be of any constructive use on a global transnational playing field.”<sup>108</sup> However, the proviso applies that this is only so taking the interpretational tools into consideration and not the term of good faith.

The Gordian knot of the concept of good faith remains unsolvable at a transnational level as long as the interpretive tools applied are diverse.

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<sup>107</sup> Summers, “*Good Faith*” in *General Contract Law*, *supra* note 17, at 198.

<sup>108</sup> Andersen, *supra* note 5, at 311.