

Good faith, or a good fake?
**The role of good faith in the performance of commercial
contracts**

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Chapter 1: Introduction

The issue of good faith in contractual performance has received increased attention over the past two decades. Focus has intensified more recently as a result of decisions of the Canadian Supreme Court, the Australian State Appellate Courts and the High Court of England and Wales respectively.¹ These rulings have re-ignited the discussion surrounding the operation of a general duty of good faith in the performance of contracts and have considered whether there should be an extension of good faith requirements to all commercial settings. As a result, good faith remains subject to debate with respect to its meaning, scope, and application.

There are strong opponents to the implication of a term of good faith in the law of contract. The criticisms directed at good faith are valid; however I will argue that the concerns they raise may be exaggerated. This dissertation will not discuss every criticism of the doctrine of good faith, but will seek to refute the three main criticisms.

The first major criticism directed at a good faith obligation in contract law, is that such an abstract, blanket term does not sit well with an understanding of the law of contract premised on an individualism.² On this basis, the courts have been unwilling to intrude upon the formation of a true adversarial bargain. The ethos of individualism underpins the classical theory of contract law, which focuses predominantly on freedom of contract. Accordingly, the terms negotiated by the parties themselves and captured in the text recorded within the four corners of the contractual page take priority. The doctrine of good faith operates outside of the terms of the contract, leading many critics to argue that such a duty is an unreasonable restriction on individual autonomy and freedom of contract.³

The second and third main criticisms leveled against a duty of good faith are interrelated. They are directed at the way such a duty appears to import increased

¹ *Bhasin v Hrynew* [2014] 3 SCR 494 *Yam Seng Pte Limited v International Trade Corp Limited* [2013] EWHC 111 (QB); *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR, *Burger King Corporation v Hungry Jack's* (2001) 69 NSWLR 55 and *Alstom Ltd v Yokogawa Australia Pty Ltd & Anor* [2012] SASC 49.

² *Yam Seng*, above n 1, at [123].

³ *Bhasin*, above n 1, at [39].

legal⁴ and commercial uncertainty into contractual agreements.⁵ Opponents suggest that good faith is contrary to the nature of common law that develops incrementally, rather than imposing broad, overarching principles.⁶ Thus, opponents have claimed that good faith cannot be introduced into the common law through traditional mechanisms of change: that is, through established legitimate processes of legal reasoning or by moulding the law to fit contemporary community standards, values and expectations.⁷ The failure of the law to develop a duty of good faith consistent with its established common law reasoning therefore increases legal uncertainty as to the foundation, role, and direction of the proposed doctrine.

The final criticism I seek to address is that good faith entails an unacceptable degree of commercial uncertainty. Legal obligations encompass a range of interests from pure self-interest to altruism. This criticism suggests that an overarching duty of good faith would confuse existing contractual solutions, requiring the exercise of a more extensive judicial discretion leading to a loss in clarity, certainty and accessibility. These concerns reflect an underlying view that very nature of commerce⁸ and good faith are not complementary. That is, in simplistic terms, the self-interested, individualistic interests in business life are at odds with more altruistic notions of good faith. On this basis, critics argue a rule of good faith generates too much uncertainty within a common law context, where certainty has been regarded as foundationally important.⁹ In the course of my dissertation, I suggest that such a fear of uncertainty, as Leggatt J considered in *Yam Seng*,¹⁰ is arguably unwarranted.

After addressing the criticisms directed at the doctrine of good faith, I will turn to the question of whether there is, or ought to be, an obligation of good faith in the performance of commercial contracts in New Zealand. Good faith can apply both at the point a contract is formed and during the period of contractual performance. The

⁴ *Yam Seng*, above n 1, at [123].

⁵ *Bhasin*, above n 1, at [79].

⁶ *Yam Seng*, above n 1, at [123].

⁷ James Davies "Why a common law duty of contractual good faith is not required" [2002] CantLR 13 (2002); 8 Canterbury Law Review 529.

⁸ "Bargains made in business life there is "a certain degree of cunning, craft, and even deceit" – *Gillespie v Russel and Son* (1859) 21 Dundl Ct of Sess 13.

⁹ Kah Leng Ter "Good Faith in the Performance of Commercial Contracts Revisited" [2014] 26 SAcLJ 111 at [123].

¹⁰ *Yam Seng*, above n 1.

issue of good faith in contract formation is both interesting and important, but is beyond the scope of this research paper. Negotiations leading to contract formation do not involve the same level of connectivity between the parties.¹¹ The negotiation stages of forming an agreement represent the most adversarial point in the prospective relationship. There is much to be won and lost for individual parties to the negotiation. However, once an agreement has crystalised, the contractual goals and purposes are set, a majority of the risks are assigned, and the powers and benefits the agreement generates are allocated. The conceptual analysis of contract formation and contract performance differs in important ways. In this dissertation, I maintain this distinction and consider the role of good faith in the phase of performance of contractual duties. Considering an obligation of good faith in contractual performance allows for a broader examination of institutional¹² expectations and related standards.¹³

In Chapter 2, I will discuss the existing role of good faith in New Zealand and seek to extract foundational principles of the duty. I go on to discuss a working definition of good faith, its three inter-related limbs, and their presence throughout the common law in Chapter 3. In Chapter 4, I address the main criticisms of good faith and offer some brief points of rebuttal. In Chapter 5, I will conclude by arguing that, on the basis of the definition adopted earlier, a duty of good faith provides an appropriate tool to bring clarity and unity to an area of law that is unsettled and unclear.¹⁴

¹¹ Vanessa Sims “*Good Faith in Contract Law: of Triggers and Concentric Circles*” [2005] 16 KCLJ 293.

¹² Social institutions are a system densely interwoven and enduring functioning across an entire society. They order the behaviour of people by means of their normative character, and general application. Contract law is a social institution, both moulding and being moulded by societies expectations.

¹³ “The Lives of the population were moulded, willingly or otherwise, to conform to the market’s demands” and Malcolm Brown “Without Morality the Market Will Destroy Itself” *The Guardian* (England, 21 December 2013).

¹⁴ Bhasin, above n 1, at [59].

Chapter 2: The current role of good faith.

Within this chapter, I examine the operation of the concept of good faith within the law as it presently stands. I explore current legal understandings of the term ‘good faith’ and seek to distil some foundational principles from recent major decisions across the common law world, and within the specific contexts in New Zealand. I identify areas of law where good faith has already been in operation and I discuss further trends that have developed with respect to identifying examples of good faith, both in practice and in breach.

‘Good faith’ as a concept can be found within common and civil law traditions, in International Trade Law and in specific areas of New Zealand legislation. Obligations of ‘good faith’ have deep roots,¹⁵ long established in doctrines of the common law of contract. These varied obligations nonetheless share foundational principles. I will explore the core principles of good faith, common to these diverse legal contexts, in an attempt to clarify what a duty of good faith entails. This will provide the basis for developing a practical working definition of the term.

Discussing the historic and contemporary relevance of ‘good faith’ in different areas of the law confirms that it is not novel concept. Rather, it can be seen an established overarching standard that operates in harmony with existing legal principles. Against this background, I argue that establishing of a principle of contractual good faith would be a legitimate and consistent development of the law. I also seek to dispel the belief that good faith is too vague to operate as a legal concept, by proposing that it generates sufficient legal and commercial certainty to operate as a workable legal construct.

2.1 Recent Common Law Development

Developments concerning an implied duty of good faith have emerged in a range of common law countries, including the United Kingdom, Canada, and Australia. The courts in these jurisdictions have, overall, demonstrated an increasing openness to

¹⁵ *Bhasin*, above n 1, at [32].

good faith. A number recent cases in New Zealand have also considered the circumstances in which a term of good faith may be implied.¹⁶ However, the meaning of good faith in contract law has not yet been thoroughly considered or comprehensively defined in New Zealand.¹⁷

(i) United Kingdom

While English contract law has not traditionally recognised a general duty of good faith in contractual performance (beyond established categories such as employment contracts and fiduciary relationships), the case of *Yam Seng Pte Ltd v International Trade Corp Ltd*¹⁸ signified departure from the established position. In this High Court decision, Leggatt J implied a duty of good faith into a distribution agreement and suggested that such a duty could have a role in commercial contracts. The Plaintiff, a firm based in Singapore, entered into a distribution agreement with the defendant, an English company, under which the plaintiff was granted the exclusive rights to distribute Manchester United products in specific regions. After fifteen months, the plaintiff terminated the agreement on the basis of the defendant's breach of contract and implied repudiation, in that they: (a) failed to ship orders promptly, (b) did not make products available, (c) undercut prices, (d) provided false information for the plaintiff to rely on, and breached an implied term of good faith. The plaintiff was successful in all its claims, seeking damages for breach of contract and misrepresentation.

Leggatt J did not believe English Law was ready for a duty of good faith to be implied as a default rule. But he had no issue with upholding a duty of good faith, based on the presumed intentions of the party, identified through the established rules of implying terms. He made the comment that good faith was heavily dependent on the factual matrix of the case, but considered the duty included the core value of honesty.¹⁹ He commented that the duty would be based on an objective assessment of whether reasonable people, in the particular context, would consider the conduct as

¹⁶ *Bobux Marketing Limited v Raynor Marketing Limited* CA 245/00.

¹⁷ *Vero Insurance New Zealand Ltd v Fleet Insurance & Risk Management Ltd* (High Court, Auckland, CIV-2007-404-1438, 21 May 2007, Asher J).

¹⁸ *Yam Seng*, above n 1, at [124].

¹⁹ *Yam Seng*, above n1, at [141].

commercially unacceptable.²⁰ Leggatt J indicated that the implication of good faith obligations would be more likely in “relational” contracts, such as joint venture agreements, franchise arrangements and distribution agreements, where there was established, ongoing connection and interaction between the parties.²¹

The UK Supreme Court has not yet resolved the contentious issue of good faith in contract performance and affirmed the approach taken in *Yam Seng*.²² However, this case nonetheless marked a significant shift in the attitude of the courts in England and Wales.²³

(ii) Canada

The Canadian Supreme Court has made definitive strides in recognising a duty of good faith. In the case of *Bhasin v Hrynew*,²⁴ the court held that there was an organising principle of good faith underlying the various doctrines governing contractual performance.²⁵ The principle was not considered to be a free standing rule, but a standard underpinning more specific doctrines that carry different weight in different situations.²⁶ The first duty created under the umbrella of good faith is a duty of honest performance.²⁷ The case involved commercial dealership agreement. It was

²⁰ At [144].

²¹ For further discussion see: David Campbell “Good Faith and the ubiquity of the “Relational” Contract” (2014) 77 Modern Law Review 475-92.

²² The High Court has endorsed and arguably expanded the approach to ‘relational’ contracts adopted by Leggatt J in *Yam Seng*. In *D&G Cars Ltd v Essex Policy Authority* [2015] EWHC 226 (QB), the court considered that obligations of “honesty and integrity” should be read into a contract for vehicle recovery, which was considered by Dove J in that case to be a “relational contract par excellence.” Further, in *Bristol Groundschool Limited v Whittingham* [2014] EWHC 2145 an agreement concerning the production of electronic training manuals was found to give rise to an implied good faith obligation (although it did not sit directly within the examples of relational agreements set out in *Yam Seng*). By contrast, in *TSG Building Services PLC v South Anglia Housing Limited* [2013] EWHC 1151 the High Court found that no good faith obligation applied to an exercise of the right to terminate set out in the contract. The High Court considered that the contractual requirement that the parties “act reasonably” and “work together individually and in the spirit of trust, fairness and mutual cooperation” did not provide a basis for implying a duty of good faith.

²³ Note that, while it was not directly on point, the Court of Appeal mentioned the *Yam Seng* decision without criticism in *NHS Trust v Compass Group UK and Ireland Limited* [2013] EWCA Civ 2000.

²⁴ *Bhasin*, above 1.

²⁵ At [63].

²⁶ At [64].

²⁷ At [93].

a continual, ongoing, relational contract for a term of three years, with an automatic renew at the end of the three-year term, subject to one of the parties giving six months' written notice to the contrary. The company decided not to renew its agreement with Bhasin. He brought an action against the company and Hrynew (his competitor), claiming that the company's conduct constituted a failure to act with good faith. It was found that Hrynew had pressured the company into the decision not to renew and that the company had dealt dishonestly with Bhasin in giving in to this pressure. The company, without consulting Bhasin, held discussions with Hrynew outlining a plan to have Bhasin work for Hrynew's agency. Further, the company misled Bhasin by telling him that Hrynew as the provincial trading officer was obliged to treat information confidentially, and that the Alberta Security Commission had rejected a proposal to have an independent person discharge this role; neither statement was true. The company was also equivocal when Bhasin asked whether a merger was a "done deal", and threatened to terminate the agreement when Bhasin continued to refuse to allow Hrynew to audit his records.

Recognition of good faith as a general organising principle together with a duty of honest performance are the most significant recent developments in the legal articulation of the duty of good faith in contract performance.

(iii) Australia

The Supreme Courts of New South Wales and South Australia have also recognised a general duty of good faith in contract performance.²⁸ While there has been no decision from the High Court of Australia on point, there is judicial weight from the State Appellate courts that suggest such recognition may be likely. The most recent case discuss good faith in detail was the South Australian Supreme Court decision of *Alstom Limited v Yokogawa Australia Pty Ltd & Anor.*²⁹ This case was concerned with the interpretation of a sub-contract between Alstom and a joint venture, YDRML, for the refurbishment of a power station in Port Augusta, which was owned by Flinders Power Partnership (FPP). FPP and Alstom entered into a contractual relationship, which subsequently broke down. After settlement with FPP, Alstom

²⁸ *Alcatel*, above n 1, *Burger King*, above n 1, and *Alstom*, above n 1, at 568.

²⁹ *Alstom*, above n 1.

commenced proceedings against YDRML for perceived breaches of their contractual obligations and duty of care. Counter claims were put forward, arguing that Alstom had failed to co-operate and act in good faith. There were particular contractual clauses that could not be utilised as a result of Alstom's failure to provide accurate and reliable programing information to YDRML. Recent decisions from the Australian courts have been relatively consistent in their approach to the meaning of good faith, frequently citing Anthony Mason's formulation of good faith as incorporating three interrelated notions: (1) an obligation on the parties to co-operate in achieving the contractual objects; (2) compliance with standards of honest conduct; and (3) compliance with standards of contract which are reasonable having regard to the interests of the parties.³⁰ Thus, recognition of a duty of good faith is gathering momentum in the courts of Australia.

(iv) New Zealand

The New Zealand courts have been the least active formulating an implied obligation of good faith. The dissent of Thomas J in the case of *Bobux Marketing Limited v Raynor Marketing Limited*³¹ represents the most notable recent engagement with the issue of good faith as an implied term. The case revolved around the right of Bobux to terminate a contract with reasonable notice. Bobux was a shoe supplier to Raynor and Raynor hoped to extend the market that they currently sold to by extending into children's shoes. The two parties could not reach an agreement as to the terms of an extended license, yet Raynor went ahead with their production of children's shoes, and traded on the goodwill of existing commercial sales of Bobux shoes. The contract allowed for termination, but only if a minimum number of shoes were not being ordered. As the number of shoes was satisfactory, the question arose of whether any other issues gave the right to terminate. Bobux relied on a breach of the mutual trust and confidence of the two parties as a means of termination. While the majority in Keith and Blanchard JJ held that the circumstances did not permit Bobux to terminate the agreement, Thomas J believed that they did. He stated that Bobux would have the right to terminate the contract for breach, with immediate effect, or alternatively that

³⁰ At [593].

³¹ *Bobux*, above n 16.

Raynor's conduct amounted to repudiation.³² Thomas J provided an opinion that good faith involved loyalty to the contractual promise. It could be said to be "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."³³

2.2 Good faith in International Sales Law

A number of proponents of the introduction of a general duty of 'good faith' in the area of contractual performance are found in the United Kingdom.³⁴ Advocates in the UK point to the law of the European Union, which has incorporated a duty of good faith through legislation such as the Consumer Contracts Regulations 1999. By proxy, this standard has effect in the Courts of England and Wales. The relevant section is in regard to unfair terms and gave effect to the continental European requirement for good faith.³⁵ So fundamentally important has the issue of 'good faith' become within the European jurisdiction that failing to recognise a general common law duty of good faith has been referred to as 'swimming against the tide.'³⁶ While New Zealand is not subject to the regulations governing a regional alliance, it is nonetheless bound by the United Nations Conventions on Contracts for the International Sale of Goods (CISG).³⁷ New Zealand's ratification of the CSIG created an international obligation on the part of the state. However, provisions of the CSIG became enforceable in the New Zealand courts through incorporation in domestic law, by way of the Sale of Goods (United Nations Convention) Act 1994,³⁸ which came into force on 1 October 1995.³⁹

³² At [47].

³³ At [41].

³⁴ Margarita N Michael "Good Faith' Movement: Swimming Against the Tide" *GAR - The European, Middle Eastern and African Arbitration Review* 2015 <<http://globalarbitrationreview.com/reviews/67/sections/232/chapters/2682/good-faith-movement-swimming-against-tide>>

³⁵ Unfair Terms in Consumer Contracts Regulations 1999 (1999) (UK) (SI 1999/2083), s 5.

³⁶ *Yam Seng*, above n 1, at [124].

³⁷ United Nations Conventions on Contracts for the International Sale of Goods (Opened for signature 11 April 1980, entered into force 11 January 1988).

³⁸ Sale of Goods (United Nations Convention) Act 1994.

³⁹ The Act applies when two parties conducting the sale and purchase of goods are based in two different countries, (with some exceptions). While the Act does apply broadly to the sale of goods, article 2 of the Act lists a number of particular transactions that the CISG does not apply to: Goods for personal use, shares, transportation vessels i.e. ships and planes, and goods purchased through an auction.

This chapter will not explore the detailed workings of the CISG, but will rather examine what good faith standards New Zealand is bound by in the international sale of goods, arguably one of the main forms of arms-length, discrete transactions.⁴⁰ Where the UK has terms of good faith incorporated through European Union law, New Zealand is bound by the CISG. The CISG includes specific reference to good faith. For example, Article 7(1) states: ⁴¹

In interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and observance of good faith in international trade.

Yet there is little guidance in the United Nations Convention as to what the good faith obligation entails. Some commentators⁴² suggest that the intention is for each country to provide its own definition of good faith. However, this fails to satisfy the major goal of the CISG, which is to provide the basis for a consistent and united international approach to contractual obligations.⁴³

Thus, while the CISG recognises a general duty of good faith, and applies in New Zealand, the convention provides little guidance with respect to the meaning and substance of good faith obligations in the context of contractual performance.

2.3 Good faith in civil law

Civil law nations, as a whole, have adopted an expansive approach to the principle of contractual good faith. The obligation was derived from the system of law applied in Roman times,⁴⁴ which required a basic tenet of good faith in commercial dealings.

⁴⁰ A discrete transaction is a one off event. The goods are exchanged at a particular point in time without an expectation of continuity. When purchasing goods, money is exchanged for the good and the contract comes to an end. Ian Macneil has argued that Classical theory of contract treats all contracts as involving discrete transactions.

⁴¹ CISG, above n 15, Art 7(1).

⁴² Paul J. Powers “Defining the Indefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods” [1999] 18 Journal of Law and Commerce 333-335.

⁴³ Powers, above n 42.

⁴⁴ Cicero gave a definition of good faith as having ‘a very broad meaning, it expresses all the honest sentiments of a good conscience, without requiring a scrupulousness which would turn

The obligation extends out of a recognition of the contracting parties existing relationships and the value of fostering civil engagement. While the doctrine is widely recognised across a number of civil law jurisdictions,⁴⁵ its application is varied and often lacks a precise definition. The German, Dutch, and Belgium civil codes provide for a good faith obligation⁴⁶, while France utilises tortious liability for pre-contractual negotiations and contract principles once the agreement has crystallised.⁴⁷

Germany has developed extensive jurisprudence, yet lacks a well-established working definition of good faith. Hesselink comments: “The result is a system of sometimes quite specific duties, prohibitions, rules and doctrines which are all part of the content of good faith. It is said to have made decisions...agreeably predictable...and rational.”⁴⁸ Summers⁴⁹ has compiled a list of examples of behaviour that the courts have found to be in breach of the duty of good faith: evasion of the spirit of the deal, showing a lack of diligence and slacking off, willful rendering of only substantial performance, abusing a power to establish compliance, and interference with or failure to cooperate in the other party’s performance.⁵⁰ Beyond these examples of breaches of good faith, Powers has extracted a definition of good faith in Germany from a close reading of number of judgments.⁵¹ He concludes that the German requirement of good faith demands that the individuals contracting respect the trusting

selflessness into sacrifice; the law banishes from contracts ruses and clever manoeuvres, dishonest dealings, fraudulent calculations, dissimulations and perfidious simulations, and malice, which under the guise of prudence and skill, takes advantage of credulity, simplicity and ignorance” - Bénédicte Fauvarque-Cosson and Denis Mazeaud “*European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules*” (European Law publishers, 2008) at 150.

⁴⁵ The doctrine of good faith is entrenched in civil law countries including Italy, The Netherlands, Poland, Portugal, Spain, Switzerland, China, Japan, Republic of Korea, Israel and the province of Quebec. Ter, above n 8.

⁴⁶ § 242 of the German Civil Code (BGB) establishes the obligation to execute contracts in good faith.

⁴⁷ Larry A. Dimatteo “*An International Contract Law Formula: The Informality of Business Transactions Plus the Internationalization of Contract Law Equals Unexpected Contractual Liability*” [1997] *L=(ii)*, 23 *Syracuse J. Int’l L. & Com.* 67, at 72 And above, n 20.

⁴⁸ M.W. Hesselink “The concept of good faith », in *Towards a European Civil Code*” [2004] *Kluwer Law International* at 486-498.

⁴⁹ Retired in 2010 after a 42 year career at Cornell Law School. He is a well-known expert for his work in contracts, commercial law, and jurisprudence and legal theory.

⁵⁰ R.S. Summers, “*Good faith in general contract law and the sales provisions of the Uniform Commercial Code*” [1969] 54 *Va. L. Rev.* 195.

⁵¹ Powers, above n 42.

relationship between the parties and act reasonably in not breaching that relationship, both before and after the contract has formed.⁵²

Italy treats good faith as more of an ethical obligation, which is a central element of the public policy surrounding commercial dealings.⁵³ Italy also offers a practical definition of good faith, as “openness, diligent fairness, and a sense of social solidarity.”⁵⁴ In addition, the Italian perspective alludes to an expectation that the social institution of law can be more forward in imposing behavioural standards on individuals.

In general terms, it would appear that, in civil law codes, it is not uncommon to find that the parties to a contract are required to show respect for each other and the agreement. They are required to avoid breaching the reasonable expectations of such a relationship.⁵⁵ However, the concept of good faith in the civil context seems to generate more interest based on its specific, contextual function rather than on its definition. Good faith has been used to limit unreasonable conduct, but has not been formulated and applied as a strict rule. While some regard good faith in the civil law as ‘watered down morality’,⁵⁶ the existence of such an obligation reflects the need for parties to be honest, cooperative, and to behave in a way consistent with the reasonable expectations of each party. Such standards facilitate the operation of contract law by fostering security and certainty in commercial dealing.

2.4 The role of Good faith in New Zealand:

In New Zealand, two particular areas of law have established a well-worn approach to implying terms of good faith into contractual agreements. Employment and insurance relationships both require, by law, that the parties to an agreement conduct themselves

⁵² Powers, above n 42.

⁵³ Nicola W. Palmieri “*Good Faith Disclosures Required During Precontractual Negotiations*” [1993] 24 Seton Hall L. Rev. 70, at 80.

⁵⁴ Palmieri, above n 53, at 204.

⁵⁵ Expectations are determined within the particular context and industry.

⁵⁶ Y.M. Laithier, “*Etude comparative des sanctions de l’inexécution du contrat*”, [2004] Pref. H. Muir-Watt, L.G.D.J., 351, at 446 and P. Le Tourneau, Rep. civ, V° Bonne foi 10.

in good faith.⁵⁷ While the meaning of good faith in each of these contexts differ, they do share similar foundational ideas and expectations. These similarities and definitions may suggest that the common law in New Zealand could develop over time a united general standard of good faith in contract.

(i) *The Employment Relations Act 2000*

The Employment Relations Act 2000 (ERA) demands that parties to an employment relationship must deal with each other in good faith.⁵⁸ Good faith in the ERA encompasses both the formation of contract along with a continuing obligation throughout the performance of the contract. Accordingly, the ERA generates a broad obligation of good faith. However, section 5 of the Act does not provide a definition of the term.

Section 4(1A)(a) states that the duty of good faith is wider than implied mutual obligations of trust and confidence. The courts had long applied obligations of mutual trust and confidence, treating them as synonymous with good faith.⁵⁹ The legislative extension under 4(1A)(a) appears to be a reaction⁶⁰ to the decision of *Coutts Cars Ltd v Baguley*.⁶¹ In *Coutts Cars*, an employer, having taken independent advice, made an employee redundant. When the employee asked for information regarding the redundancy decision-making process as to who would be made redundant, the employer, on poor advice, refused the request. The Court of Appeal deemed the failure to consult in the redundancy process to be a breach of the duty of good faith.

The Court of Appeal refers to *Aoraki Corp Ltd v McGavin*⁶² as outlining the narrower approach taken to good faith in the employment context prior to the introduction of the ERA. In that case, the grievance occurred the day after the ERA came into force, and the ERA showed a clear intent to broaden the duty of good faith applicable in an employment context. The court in *Coutts Cars* held that the special nature of the

⁵⁷ Employment Relations Act 2000; *Rozanes v Bowen* (1928) 32 Ll LR 98 at 102 and *Dome v State Insurance General Manager* (1987) 5 ANZ Insurance Cases 60-835.

⁵⁸ Employment Relations Act 2000, s4(1)(a).

⁵⁹ *Aoraki Corp Ltd v McGavin* [1998] 1 ERNZ 601; [1998] 3 NZLR 276; (1998) 5 NZELC 95,767 (CA).

⁶⁰ John Burrows, Jeremy Finn and Stephen Todd “*Law of Contract in New Zealand*” (Fourth Ed, Lexis Nexis, Wellington 2012).

⁶¹ *Coutts Cars Ltd v Baguley* [2002] 2 NZLR 533.

⁶² *Aoraki Corp Ltd v McGavin* [1998] 1 ERNZ 601; [1998] 3 NZLR 276; (1998) 5 NZELC 95,767 (CA).

employment relationship imposed mutual obligations of trust and confidence.⁶³ This was an established obligation arising out of the nature of the relationship, and not a result of statutory imposition through the ERA. Previously the courts had recognised good faith as a qualifier of conduct. The legislature, however, looked to expand the common law understanding into the more serious duty that applies today, where consultation is a corollary of good faith.⁶⁴

Coutts Cars made it clear that the obligation of good faith existed at common law prior to its statutory incorporation in the ERA. It was not a new, untested term. The legislature has been happy to rely on, and when necessary adapt, the existing Common Law understandings of good faith within employment relationships.

In *Carter Holt Harvey Ltd v National Distribution Union*,⁶⁵ the Court of Appeal noted that good faith requires “honesty, openness and absence of ulterior purpose or motivation”.⁶⁶ In that case, an employer’s failure to allow employee representatives to inspect the plant area during an employee strike was alleged to be a breach of good faith. The employer had prevented access in order to avoid discrimination against those workers who were not involved in the strike. When the representatives sought access, company managers brought proceedings against them.

The Court discussed whether a breach of good faith should be determined subjectively or objectively. This is an important distinction. An external, objective standard of behaviour offers a practical measure, but this stands in tension with understandings of good faith as a duty of morality which should be considered subjectively. The Court considered that a rigid assessment would not be of great assistance.⁶⁷ Thus, *Carter Holt Harvey* determined that good faith required reasonableness and honesty, addressed in the context of the case. To determine a breach of good faith, the courts must therefore have regard to all information and steps taken by the parties.

⁶³ *Coutts Cars*, above, n 61, at [42].

⁶⁴ At [8].

⁶⁵ *Carter Holt Harvey Ltd v National Distribution Union Inc* [2002] 1 ERNZ 239 (CA).

⁶⁶ At [55].

⁶⁷ *Carter Holt*, above at n 65, at [55].

There has been reluctance to promote a prescriptive set of rules regarding the meaning and requirements of good faith in employment law. However, the courts appear to appreciate the importance of good faith as a broad objective within the ERA. Good faith encourages and promotes positive behaviour in employment relationships.⁶⁸ The operation of good faith in the sphere of employment shares similarities with other expressions and understandings of good faith. However, the duty to consult and to have open, reactive dealings generate a slightly more onerous duty in this context. The employment law definition of good faith carries with it expectations of transparency and honesty, and fair and reasonable behaviour. The case law associated with the ERA, and those employment cases preceding it, have drawn on established understandings, and outlined useful foundational principles⁶⁹ which serve to clarify our understandings of good faith.

Employment contracts are an important feature of the landscape of commercial endeavour, mediating the key relationship between business owner, manager and worker. Upholding good faith in an employment context has been described as a common sense approach to reducing conflict and other problems.⁷⁰ Current models of good faith do entail a certain degree of uncertainty,⁷¹ as with many legal concepts. However, the courts have effectively applied the principle to the facts, and determined whether behaviour should be considered to breach good faith according to established method.

(ii) Insurance Contracts

A second area of law where the courts are comfortable applying an obligation of good faith within a specific commercial context is in the realm of insurance contracts. The implication of ‘good faith’ within insurance law became necessary because of a

⁶⁸ *Wellington City Council v Body Corporate 51702 (Wellington)* [2002] 3 NZLR 486 (CA) at [25].

⁶⁹ In broad terms, this means that both employers and employees must: Act honestly, openly, and without hidden or ulterior motives, raise issues in a fair and timely way, be constructive and cooperative, be proactive in providing each other with relevant information and consider all information provided, respond promptly and thoroughly to reasonable requests and concerns, keep an open mind, listen to each other and be prepared to change opinion about a particular situation or behaviour, and treat each other respectfully.

⁷⁰ Ministry of Business Innovation and Employment, “Good faith” New Zealand at work <<http://employment.govt.nz/er/solvingproblems/keyprinciples/goodfaith.asp>>

⁷¹ *Davies*, above n 7.

common market failure, namely asymmetric information. This situation arises where one party holds most or all of the information regarding an agreement. As a result, the law requires them to act ‘uberrima fides’ or with utmost good faith.⁷²

Within insurance law, the obligation of good faith is understood to require full disclosure of material facts that are known by the assured, or ought to be known in regards to the particular circumstances of the insurance contract.⁷³ Requiring full disclosure is based on three inherent values, those of honesty, co-operation (to make this type of contract function), and reasonableness.

Honesty requires that all facts materially relevant to a particular assurance contract should be disclosed. The requirement to disclose reflects an implied obligation to co-operate. Without such co-operation through disclosure insurance contracts could not function. The expectation of reasonableness on the part of the party seeking to be ‘assured’ involves the disclosure of information that a party ‘ought’ to know. This view of good faith reflects an expectation that not only will the assured be honest and co-operate, but they will seek out the information that is necessary to make such a contract workable. Without these contractual efficacy may be compromised, as its effectiveness is based on the speculation of particular facts and their contingent chances of occurrence.⁷⁴ Thus, values of both honesty and reasonableness are implied into such contracts by the courts. There is no acceptance of, or sympathy for, any cunning or deceit. There is, rather, an appreciation that for such a contract to be workable, each party, but more importantly the party with all the information, needs to be open and reasonable towards the other.

Further exploration of insurance contracts, their relationship to utmost good faith, and the development of distinct doctrine in the insurance context⁷⁵ is beyond the scope of this paper. Nonetheless, this brief examination of good faith as it has developed in

⁷² This obligation is not new, having been established around the eighteenth century - *Carter v Boehm* 97 ER 1162.

⁷³ A material fact is seen as something that would affect the mind of a prudent insurer, even though the assured may not have considered its relative importance. *London Assurance v Mansel* (1879) 11 Ch D 363 and *Lambert v Co-operative Insurance Society* [1975] 2 Lloyd’s Rep 485.

⁷⁴ Burrows, Finn, and Todd, above n 60, at 11.4.2.

⁷⁵ Sims, above n 11.

insurance law provides an understanding of the historical depth and commercial scope of the duty. Insurance law's utmost good faith doctrine can contribute to the development of a working understanding of good faith within the area of commercial contracts generally. Any broader debate, however, requires the meaning and scope of good faith in contractual performance to be more fully unpacked and developed.⁷⁶

(iii) Express provisions:

Good faith has not only been implied by the courts and imposed by the legislature. At times, parties have undertaken the duty expressly. The courts have also had to determine the meaning and scope of good faith obligations in the context of these express provisions. Commentators have recognised the difficulty of assessing these provisions objectively, let alone subjectively assessing in terms of what the parties' actual intentions might have been.

In *Symphony Group Ltd v Pacific Heritage (Auckland) Development Ltd*⁷⁷ the court considered an express term of good faith in a Joint Venture agreement. Clause 6 of the agreement provided that "the success of the Joint Venture is in part dependent on the parties working together in good faith... and each does agree that it will at all times act in good faith."⁷⁸ The Joint Venture concerned the development of a section of land, in a two-stage process, into apartment blocks. Both parties agreed to fund the project 50/50, and to appoint a management committee comprising two members representing each party. The subsequent breakdown in the relationship between the two parties resulted from external business pressures and communication failures, leading each party to accuse the other of a breach of good faith. In determining the scope of the contractual obligation, Paterson J referred to *Mogridge v Clapp*,⁷⁹ which held that good faith was "a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith." Paterson J held good faith, when taken as a whole, was to be a form of 'excluder' without a general meaning of its own.⁸⁰ The court engaged with the type of ambiguity inherent

⁷⁶ Sims, above n 11.

⁷⁷ *Symphony Group Ltd v Pacific Heritage (Auckland) Development Ltd*, CP362/98, 17 August 1998.

⁷⁸ *Symphony Group*, above n 77, at [12].

⁷⁹ *Mogridge v Clapp* [1892] 3 Ch 382 (CA).

⁸⁰ *Symphony Group*, above n 77, at [17].

in the term and utilised it as a discretionary tool to rectify what they regarded as unreasonable conduct.

On the facts, it appeared that neither party took notice of the duty to act in good faith during the period of contract performance, prior to the dispute arising. Paterson J found that both parties had taken steps that were in breach of good faith. The failure to act, or to be decisive in making decisions, with the intention to frustrate a contract, did not constitute acting in good faith. Likewise, failing to disclose information to the other party for their approval was also a breach of good faith.

Moreover, in the case of *Vero Insurance New Zealand Ltd v Fleet Insurance & Risk Management Ltd*,⁸¹ Asher J discussed the conflict between two clauses in a contract. Clause 5.1 first gave an absolute discretion to refuse consent, while clause 4.1.1 required that at all times during the term the parties must “act in good faith towards each other in relation to the company.”⁸² It was argued that utilising a clause of ‘absolute discretion’ in an attempt to escape a contractual burden was a breach of good faith. Asher J was mindful of the three notions applied by the Australian courts as refined by Anthony Mason: to co-operate, be honest and act reasonably.⁸³ As such the refusal of FIRM to consent to a change of control and their attempt to place the company in liquidation as a means of escaping the contract were held to be unreasonable. Thus, in their interpretation of an express term of good faith the New Zealand courts have shown a movement away from the idea of good faith as a general excluder, towards a more substantive definition, adopting the three interrelated duties set out above.

In these two examples, the expectations of parties in a good faith arrangement do have common inherent characteristics. The parties in *Symphony Group* (in a Joint Venture context) had an obligation to consult with each other, to respond to queries, and to not arbitrarily withhold information or necessary consent as means to frustrate the contract. *Vero Insurance* (also a joint Venture arrangement) implemented a more definitive approach incorporating three interrelated duties. However each case

⁸¹ *Vero Insurance New Zealand Ltd v Fleet Insurance & Risk Management Ltd* [2007] BCL 673.

⁸² At [40].

⁸³ At [45].

recognised similar characteristics in relation to good faith aligning generally with the themes of co-operation, honesty and reasonable behaviour.

2.4 The New Zealand framework

Having examined the current understanding of good faith in the domestic law of New Zealand, it is clear that there have been few consistent substantive parameters by either case law or legislation. While employment and insurance law provide for an obligation of good faith, neither outlines a strict doctrinal definition. The court has also had to construct meaning with respect to express provisions of good faith. While the application of the principle of good faith has been highly dependent on the factual matrix of the case, there are nonetheless some common principles that emerge.

The employment context suggests that a higher level of loyalty beyond mere co-operation is embodied by standards of good faith in this context. While this understanding is not overt in insurance law, the same values can arguably also be implied in that context. Insurance contracts are voidable if good faith, referred to as a duty of disclosure, is breached. Without disclosure, there can be no enforceable contract because the agreement becomes unworkable. The parties must co-operate to facilitate a contractual purpose requiring a mixed subjective and objective honesty. Finally, when parties expressly bind themselves to a contractual standard of good faith, this has been interpreted to exclude bad faith. Clear instances of bad faith include situations where have been when parties have attempted to frustrate the agreement, or act in an underhanded way towards the other party as a means of undermining the contract.

It does therefore appear that in a number of New Zealand's domestic law contexts, there is an expectation that contracts, including but not limited to in areas of insurance and employment, will incorporate basic requirements of co-operation and honesty. Neither of these standards are applied through a strict formalistic approach. The court has utilised the 'reasonable man' test to determine whether the standard in question has been unreasonably breached. Such values, while abstract, have provided enough certainty to be legally workable and have developed in a manner consistent with case law.

Values of co-operation, honesty and reasonableness are therefore consistent with New Zealand's understanding of good faith. They also accord with the approach taken in a number of comparable jurisdictions. The following chapter will further develop these core values, and examine the involvement and recognition of each of them within the common law.

Chapter 3: Developing a Working Definition of Good Faith

3.1 Theoretical approach and working definition:

It is anticipated that in developing a working definition of good faith, both case law and scholarship will offer different views and conclusions as to its nature and scope. The broad spectrum of circumstances⁸⁴ within which good faith obligations can be found makes it difficult to develop a precise definition. However, the examples previously discussed demonstrate that good faith already exists in New Zealand domestic law and also operates internationally. It functions as a legal doctrine and operates in practice to avoid a level of uncertainty that would render contract law unworkable.

As discussed earlier, Sir Anthony Mason,⁸⁵ writing extra-judicially, suggests that three interrelated notions have emerged as the foundation of a good faith obligation.⁸⁶ These warrant further consideration:

- (a) Co-operation in achieving the contractual object;
- (b) Compliance with honest standards of conduct; and
- (c) Compliance with standards of conduct which are reasonable having regard to the interests of the parties.

These three expectations are derived from United States experience following the codification of good faith in the *Uniform Commercial Code*⁸⁷ and the *Restatement (Second) of Contracts*.⁸⁸ Mason recognises that these rules pertaining to good faith are not expressly outlined and that, historically, other common law jurisdictions have deployed good faith as a general excluder. Mason advanced a broader notion of good faith as a “sense of loyalty to the promise itself and as excluding bad faith

⁸⁴ ‘A commentator suggested good faith has in some jurisdictions lead to a distortion of fiduciary law’ – Davies, above n 2 and Paul Finn “*The Common Law and Morality*” (1989) 17 MULR 87 at 96.

⁸⁵ Australian Judge and 9th Chief Justice of the High Court of Australia.

⁸⁶ Anthony Mason “*Contract, Good Faith and Equitable Standards in Fair Dealing*” (2000) 116 LQR 66.

⁸⁷ Uniform Commercial Code, (2001) (USA) § 1-304

⁸⁸ Restatement (Second) of Contracts, (1981) (USA) § 205.

behaviour.”⁸⁹ For the purposes of this dissertation, I do not intend to utilise the broader good faith as part of my working definition. This is for two reasons. First, the role of an excluder does not provide any more substantive guidance and generates as much judicial discretion – a basis which good faith has been criticised for and often described as value-based or a normative judgment.⁹⁰ Secondly, associating good faith with loyalty has led to criticisms that good faith is analogous to a fiduciary duty. As the court has attempted to extend the scope of the fiduciary principle, good faith has at times been tarred with a similar brush, in light of the requirement that individuals should act altruistically.⁹¹ As such, it would be wise to avoid incorporating this term in any definition of good faith. Further, loyalty acts as an abstract concept. A protean phrase, by substituting loyalty for honesty and co-operation we would address these concerns, and utilise obligations already in operation within the law of contract. Some, if not all, of the three notions are apparent in a significant number of the cases that address good faith in New Zealand law.

I will focus on these in turn, with a view to forming a workable definition of good faith. The first two elements, namely co-operation and honesty, are assessed against a strict standard. Opponents of good faith conceive it as a form of subjective morality,⁹² yet by incorporating strict objective standards of co-operation and honesty into the definition, both concerns relating to judicial discretion are minimised. However, good faith does not entail the imposition of an impossibly high standard upon commercial actors. Breach would occur only where the actions of the party concerned were deemed unreasonable. Thus, The third element of this definition of good faith utilises the common law’s tool of the reasonable man as a way to produce a just result.

The following section examines recent case law development in a range of comparative common law jurisdictions in light of each of the three limbs of the working definition and the development of good faith. I consider development in New Zealand, Canada, the United Kingdom, and Australia and explore the treatment and role of each of the limbs and also addresses how good faith as a standalone doctrine

⁸⁹ *Mason*, above n 86, at 3.

⁹⁰ *Davies*, above n 7.

⁹¹ *Davies*, above n 7, at 5.

⁹² *Sims*, above n 11.

has been applied. This exploration seeks to determine whether there is an identifiable pattern of consistency in the developments in these states with respect to individual duties, and whether the common law is drawing closer to developing a doctrine of good faith in contractual performance than may have previously been the case.

3.2 Cooperation

Duties to cooperate and facilitate the success of a bargain can be identified within the common law. Broadly, the duty to cooperate has been defined as an obligation to not prevent or frustrate the contractual purpose of the other party.⁹³ There have been suggestions that such an obligation should encompass a positive duty, requiring parties to do all that is reasonably necessary to acquire the intended objects of the contract.⁹⁴ While there have been differing applications of the doctrine of cooperation, a general understanding of its scope can be understood as the need for contracting parties to facilitate the performance and the realisation of the contractual purposes.⁹⁵ The following sections explore the treatment of the duty to cooperate, the first limb of our working definition of good faith, in a number of common law jurisdictions. This discussion will shed light on how the working definition of good faith set out above, operates in practice.

(i) United Kingdom

The UK has long recognised a duty to co-operate in the achievement of the contractual purpose. *Mackay v Dick*⁹⁶ is the oft-cited case in this regard. There, it was held that “as a general rule...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.”⁹⁷ Although it was stated as a general rule of construction, the extent of the duty was always to be tempered by the circumstances of the particular case. The issue central to *Mackay v Dick* was the

⁹³ *Shepard v Felt and Textiles Australia Ltd* (1931) 45 CLR 359, at 378 per Dixon J.

⁹⁴ J Edward Bayley “*A Doctrine of Good Faith In New Zealand Contractual Relationships*” (LLM, University of Canterbury 2009).

⁹⁵ Bayley, above n 94, at 103.

⁹⁶ *Mackay v Dick* (1881) 6 App.Cas. 251.

⁹⁷ *Mackay v Dick*, above n 96, at 263.

failure of one party to excavate the necessary land to allow for a steam navvy⁹⁸ trial. Such a requirement was not expressly outlined in the contract, but was necessary to allow the party to achieve its purpose under the contract. The appeal was under Scots Law and, as a result, was heavily influenced by civil law customs.⁹⁹ The decision by Lord Blackburn relied on an early 1469 decision that his Lordship considered to be of ‘obvious good sense and justice.’¹⁰⁰ The duty was formed from a construction of the contract and the implication of a promise that was necessary to give the contract its effect.¹⁰¹ The case has since been applied and considered in a wide variety of legal and jurisdictional circumstances.

(ii) Australia

Australia has developed some of the most comprehensive applications of a duty to co-operate in contractual arrangements. As Callinan J said: ‘it is a well settled rule of the construction of contracts within Australia that each party owes to the other a duty to co-operate.’¹⁰² The meaning of the doctrine within Australian jurisprudence has been further refined to entail not preventing the performance of the contractual purpose of the other party.¹⁰³ Mason J has advanced the duty further, stating “it is common ground that the contract imposed an obligation on each party to do all that is reasonably necessary to secure the performance of the contract.”¹⁰⁴ Such an obligation is an implied term in construction contracts. In effect, parties cannot frustrate the contractual aims for their own extraneous purposes. Although the application of the doctrine is tempered by standards of reasonableness, as are all implied terms, contractual powers cannot be applied or withheld for capricious reasons that do not facilitate the performance of the contract and the achievement of its purpose. Such a

⁹⁸ A type of steam crane.

⁹⁹ Arthur McInnis *The New Engineering Contract: A Legal Commentary* (Thomas Telford Publishing, London, 2001) at 80.

¹⁰⁰ *Mackay v Dick*, above n 94, at 264

¹⁰¹ *McInnis*, above at n 99, at 80

¹⁰² *Concrete Pty Ltd v Parramatta Design & Developments* (2006) 231 ALR 663, at 704 per Callinan J.

¹⁰³ *Shepard Felt and Textiles of Australia Ltd*, above n 91, at 378 per Dixon J.

¹⁰⁴ *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 607-608.

duty has been held to apply to both the acts and omissions of parties to a contract.¹⁰⁵

Alstom Ltd v Yokogawa Australia Pty Ltd & Anor confirmed that “the implication of a term that the parties to a commercial contract agree to do all that is necessary to be done on their part to enable the other party to have the benefit of the contract is well recognised and is not controversial.”¹⁰⁶ While it was held that the implied obligation to co-operate could not overrule the express clauses of the contract, the court nonetheless confirmed the general nature of the obligation, stating that ‘a duty to co-operate is a general rule applicable to every contract, and that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have benefit of the contract.’¹⁰⁷ In this manner, the Australian courts have extended the duty to co-operate from a fact and context specific duty to a generally implied contractual term.

(iii) Canada

The Canadian courts have also been relatively expansive. In the last decade, in their recognition of a contractual obligation to provide for fair outcomes the courts have recognized good faith as a general organizing principle and a means of ensuring the performance and enforcement of the contractual objectives.¹⁰⁸

In *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*,¹⁰⁹ the parties to a real estate transaction failed to specify in the sale and purchase agreement which party was to have the responsibility of acquiring planning permission for a subdivision of the property. The legal process meant the vendor was the only party capable of obtaining such permission. The Court held that the vendor was under an obligation to use reasonable efforts to secure the permission. Dickson J said: “the vendor is under a duty to act in good faith and to take all reasonable steps to complete the sale”.¹¹⁰ It is

¹⁰⁵ Julian Bailey “*Construction Law*” (Informa Law, UK, 2011) at 7.28.

¹⁰⁶ *Alstom*, above n 1.

¹⁰⁷ At 572.

¹⁰⁸ *Bhasin*, above n 1, at [49].

¹⁰⁹ *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072.

¹¹⁰ At 1084.

not clear whether the duty was imposed as a matter of law, or implied based on the parties' intentions. Where duties of good faith have been implied into Canadian contracts, it has been to ensure that the parties do not act to defeat the objectives of the contract.¹¹¹ In this way, Canadian case law has often associated notions of good faith with ideas of co-operation and facilitation.

(iv) New Zealand

While Australia has taken a liberal approach to the duty to cooperate, New Zealand has adopted a more conservative position with respect to the inclusion and extension of a duty to co-operate. The courts have shown a reluctance to impose a general term of co-operation outside of the express terms of the agreement. They have been more comfortable implying a term where they consider the circumstances warrant it.¹¹² In a similar manner to the United Kingdom this has led to a more piece-meal approach to the implication of a duty to co-operate. Cooke J, for example, recognised that such an obligation would be implied based on the nature of the contract and the relationship between the parties.¹¹³

A duty to cooperate has been more actively applied in the context of 'relational contracts,'¹¹⁴ for example, joint venture contracts.¹¹⁵ The duty is especially appropriate within such arrangements, which are predicated upon mutual trust, confidence and the ability to effectively collaborate. The courts have also been willing to apply such a duty into commercial contracts where collaboration is deemed to be a central element. While the courts have applied a duty to collaborate as a matter of law within joint venture contracts, they have been flexible in their implication of such a term in other circumstances, based on the facts of the case. A duty to co-operate has also been

¹¹¹ *Peel Condominium Corp No 505 v Cam-Valley Homes Ltd* (2001) 196 DLR (4th) 621, and Geoffrey Kuhne "Implied Obligations of Good Faith and Reasonableness in the Performance of Contracts: Old Wine in New Bottles?" [2006] 33 UWAL REV.

¹¹² *Bayley*, above n 94, at 103.

¹¹³ *Devonport Borough Council v Robbins* [1979] 1 NZLR 1, at 29.

¹¹⁴ A relational contract is based upon trust between the parties. The explicit terms of a contract are just an outline of expectations. There are implicit terms and understandings that determine the behaviour of the parties in what is often an on-going, longer-term commercial relationship.

¹¹⁵ *Prophecy Mining No Liability v Kiwi Gold No Liability* (High Court, Auckland, CP 2264/88, 8 August 1990) at 14 per Thomas J.

implied in the sale and implementation of software,¹¹⁶ where the nature of the relationship, the higher degree of reliance, time pressure, and capital investment, meant that co-operation was found to be an appropriate additional term to be applied beyond the express provisions of the contract.

Although there is no consensus as to the existence of a general duty to co-operate, such a duty is neither “foreign to the common law, nor manifestly uncertain.”¹¹⁷ Analogies can be drawn between the applications of a duty to cooperate (for example, in the case of relational contracts in New Zealand and the like) and the existence of a more general duty of good faith.¹¹⁸ Co-operative behavior is a basic tenet of an obligation of good faith. A duty to co-operate is not a novel legal concept, nor does it generate uncertainty within the common law landscape. As such, the duty to co-operate and facilitate contractual purpose, in my view, represents the first element of an operational definition of good faith. It is already deployed, in ranging circumstances and to differing degrees and is already operational, within the common law.

3.3 Honesty

The requirement of honesty is a fundamental aspect of good faith and also accords with the expectations of most parties within contractual relationships.¹¹⁹ A definition of honesty first requires an assessment of whether a standard of ‘subjective honesty’, ‘objective honesty’, or something in between should be applied. In general terms, to maintain subjective honesty, a party must have a clear conscience or lack a guilty mind.¹²⁰ In order to breach this requirement, a party would need to establish an intent to deceive, mislead or operate according to an ulterior motive, outside the contract. There are a number of commentators who favour this test of honesty.¹²¹

However, the New Zealand Court of Appeal considered the determination of a subjective requirement of good faith would present evidential difficulties and generate

¹¹⁶ *Williams & Adams Ltd v Computer Systems Implementation Ltd* (High Court, Wellington, CP 215/92, 9 March 1995, Ellis J).

¹¹⁷ *Williams & Adams Ltd*, above n 92.

¹¹⁸ Burrows, Finn and Todd, above n 60, at 2.2.6.

¹¹⁹ *Bhasin*, above n 1, and *Yam Seng*, above n 1.

¹²⁰ David McLauchlan “*The Agreement to Negotiate in Good Faith: A Non-Justiciable Contract?*” (2005) 11 NZBLQ 454.

¹²¹ *McLauchlan*, above n 120.

a degree of indeterminacy that is beyond judicial consideration.¹²² Moreover, as the good faith doctrine is often viewed as an attempt to protect the reasonable expectations of parties, such a subjective element would be counterintuitive. A more pragmatic definition of honesty would be in keeping with traditional notions of civil liability, that is, honesty decided from an objective standpoint. In this manner, the court would determine whether the particular behaviour represented a breach of the honesty expected by the other contracting parties, and by society. Such a definition would bring the law into alignment to the reasoning in the dissenting decision of Lord Millett in the English House of Lords case of *Twinsectra Ltd v Yardley*.¹²³

The majority in that case favored a mixed subjective, objective approach when considering honesty in the context of a breach of trust. Such an approach was not uncommon in commercial and professional relationships.¹²⁴ The majority held that for a person found to be dishonest, there would have to be a breach of the objective standards expected by ordinary people. However, in addition, the party concerned would also have to appreciate (subjectively) that by those standards they were acting dishonestly. This last term was the basis of disagreement from Lord Millett, who reasoned that civil liability is concerned with the conduct of a defendant rather than their state of mind. Such a requirement introduces a number of practical difficulties, and could allow a certain amount of ‘Robin Hood’ behaviour.¹²⁵

For this working definition to function effectively, I propose that the limb of honesty should involve an objective test. Objective honesty provides a more certain basis and removes practical difficulties that otherwise arise during judgment. However, the honesty requirement on which the good faith obligation can rest must be tempered by the reasonableness element of the third and final limb of good faith. This pragmatic approach avoids the necessity of proving subjective intentions, which presents difficulties when dealing with corporations. The balance between the second and third limb of the test for a breach of good faith would bring it more closely in line with the

¹²² *Wellington City Council v Body Corporate 51702* (Wellington) [2002] 3 NZLR 486, at 495-496 per Tipping J.

¹²³ *Twinsectra Ltd v Yardley* [2002] 2 All ER 377.

¹²⁴ *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97 and *US International Marketing Ltd v National Bank of NZ Ltd* [2004] 1 NZLR 589.

¹²⁵ Bayley, n 94, at 105.

balance sought by the majority in *Twinsectra Ltd v Yardley* and would better provide for fair outcomes.

(i) United Kingdom

In *Yam Seng*, the English decision discussed earlier which promoted a general duty of good faith, the court stated that: “a paradigm example of a contractual norm which underlies all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically on trust.”¹²⁶ Requiring honesty was no revolutionary shift within the law. Rather, commerce occurring against a background of honesty has been a principle recognised by the House of Lords for some time.

The House of Lords in *HIH Casualty v Chase Manhattan Bank*¹²⁷ considered an express term, which gave rise to the ability to be intentionally deceitful when interpreted strictly. The contract provided that the insured should have “no liability of any nature to the insurers for any information provided”. The question was whether this clause would protect against the intentional provision of fictitious information. The House of Lords affirmed the lower courts and determined that although a literal reading of the clause would cover deceitful statements, it could not reasonably be understood as having that meaning. As Lord Bingham stated: “Parties entering into a commercial contract...will assume the honesty and good faith of the other; absent such an assumption they would not deal.”¹²⁸ Leggatt J went on to say in *Yam Seng* that “the requirement that parties will behave honestly is so obvious that it goes without saying.”¹²⁹

The court also recognized that honesty, as a central tenet of trust, was essential to commerce, and that the requirement of honesty was necessary to give business efficacy to commercial transactions.¹³⁰ Thus, honesty occupies a central position in the interpretation and construction of contracts in the UK. The courts have been

¹²⁶ *Yam Seng*, above n 1, at [135].

¹²⁷ *HIH Casualty v Chase Manhattan Bank* [2003] 2 Lloyd’s Rep 61.

¹²⁸ At [15] per Lord Bingham.

¹²⁹ *Yam Seng*, above n 1, at [137].

¹³⁰ *Yam Seng*, above n 1, at [137].

willing to imply a duty of honesty as a means of both affirming the true intention of the parties and of giving business efficacy to contracts where necessary.

(ii) Australia

Australia has adopted a broad approach to good faith. As a result, the law of good faith in the performance of contracts in Australia is still developing and remains, to a certain extent, unsettled.¹³¹ Even so, it is clear that the duty of good faith requires an adherence to standards of honest conduct.¹³² The modern recognition of a duty to perform contracts in good faith was set out by Prestley JA in *Renard Constructions (ME) Pty Ltd v Minister of Public Works*,¹³³ and in *Burger King Corporation v Hungry Jack's*,¹³⁴ Prestley JA ruled the actions of Burger King Corporation (BKC) were held to be neither reasonable nor for a legitimate purpose.¹³⁵ The dispute arose from BKC's interest in entering the market directly as opposed to through existing franchising agreements between BKC and Hungry Jack's. The dispute centred on the conflict between the application of two contractual clauses. Clause 2.1 allowed Hungry Jack's to open four new stores a year, while clause 4.1 made all prospective Hungry Jack's restaurants subject to BKC's operational and financial approval. The dispute came to a head when BKC refused all franchisees their operational and financial approvals, as required under clause 4.1. The court held BKC's actions to be to be contrary to legitimate interests under the development agreement. They were deemed to be efforts to hinder Hungry Jack's and "did not conform with an honest person's view of what would constitute fair dealing."¹³⁶

A number of Australian State appellate courts,¹³⁷ in their recognition of a duty of good faith, have cited the limbs of good faith discussed within the working definition, the second being compliance with honest standards of conduct. That is, there is a judicial weight of expectation for parties to act honestly, and for the prospective expansion of this duty as part of a broader principle of good faith.

¹³¹ E. Peden "Good faith in the performance of contract law" (2004), 42 *L.S.J.* 64 at 64.

¹³² A. Mason, above n 86, and *Burger King*, above n 1, at [171] and [189].

¹³³ *Renard Constructions (ME) Pty Ltd. v. Minister for Public Works* (1992), 26 N.S.W.L.R. 234 (C.A.).

¹³⁴ *Burger King*, above n 1.

¹³⁵ At [189].

¹³⁶ At [189].

¹³⁷ *Alstom Limited*, above n 1 and *Alcatel*, above n 1 and *Burger King*, above n 1.

(iii) Canada

Canada has taken definitive steps to uphold fair dealing recognized in their organising principle of good faith, which was accompanied by the implication of a general duty of honesty in contractual performance.¹³⁸ This duty operates to deter any parties from intentionally lying or misleading the other party. It does not impose a positive duty of disclosure or require one party to forego its own interests in favour of the interests of another. The recognition of a duty of honesty was held to be “a modest, incremental step”, as the requirement for honesty between parties is one of the most commonly recognised principles of good faith.¹³⁹

In the case of *Bhasin*, Cam-Am misled Bhasin and was intentionally dishonest in their communications. Such behaviour was found to be in breach of the new implied duty of honesty in contractual performance. The decision did not set out a specific test for what would constitute a breach of honest dealing. The definition has been left in the hands of future judges who will need to balance the meaning of honesty with an understanding that the parties must behave reasonably. Ideas of reasonableness and honesty arise in other areas of the law, and judges have shown themselves well able to address them.¹⁴⁰ Honesty is a concept within the grasp of the general public. In general terms, it does not involve a positive disclosure of information, but if asked, it requires one to provide a truthful response.¹⁴¹

The requirement of honesty has received substantial attention in the common law, as I have discussed. The courts have been eager to restrict parties hoping to benefit from obvious dishonesty. While differing standards operate in the criminal and civil law to determine whether someone has been honest, it appears that in a contractual setting the courts have looked for a balanced approach. Overall, a positive duty on parties to disclose information to each other has not emerged. Rather, parties are expected not to mislead. The courts would not look favourably on a dishonest or equivocal response

¹³⁸ *Bhasin*, above n 1, at [73].

¹³⁹ *Bhasin*, above n 1, at [73].

¹⁴⁰ David Dias “SCC establishes duty of honesty between contracting parties” (13 November 2014) Legal Feeds – The Blog of Canadian Lawyer & Law Times
<<http://www.canadianlawyermag.com/legalfeeds/2379/scc-establishes-duty-of-honesty-between-contracting-parties.html>>.

¹⁴¹ *Dias*, above n 140.

to a direct question. Thus, for practicality, this limb of good faith ought to be assessed objectively on the basis of the information a party provided or the response that was given. However, it would be just, as the strict approach would be tempered by the third limb ensuring that the breach was unreasonable in the circumstances.

3.4 Reasonable Expectations

Applying a contractual term as based on the reasonable expectations, or an interpretation, from the vantage point of the reasonable man has been found regularly in the common law. While ‘reasonable expectations’ have been understood in different ways,¹⁴² it has still remained a consistently applied principle in the UK and other common law jurisdictions. An exploration of the uses of a tool of reasonable expectations suggests that the law has been comfortable operating with terms that do not provide the necessary certainty required by particular opponents of good faith.¹⁴³ Moreover, many have considered a broad overlap of content and a close relationship between reasonableness and good faith. If a term of reasonableness has been actively and broadly applied, albeit within particular circumstances at the court’s discretion, it appears that opponents to good faith may have failed to recognise the consistency that the principle of good faith has with legal principles and rules already in operation, such as reasonableness.¹⁴⁴

An expectation for contracts to abide the expectations of reasonable parties is found in different areas of law, both civil and contractual. The court is frequently required to determine what conduct is reasonable in negligence cases. Likewise, contract interpretation and construction have imported the use of the reasonable man test. The courts have utilised this standard to construe the meaning of contractual words and clauses, the role of the factual matrix, and when terms have been implied into the contract.

The following section explores contract law’s use of the tool of reasonable expectations across a number of distinct contractual issues.

¹⁴² Stephen A. Smith “‘*The Reasonable Expectations of the Parties*’: *An Unhelpful Concept*” (26 February 2009) Faculty of Law, McGill University at 2.

¹⁴³ Davies, above n 7.

¹⁴⁴ The concept of reasonableness does not attract the same fears and criticism of uncertainty that are directed at good faith.

(i) United Kingdom

The interpretation of contracts has led the courts to resort to using an objective standard of reasonableness. The courts have utilised the reasonable man test when a straightforward interpretation of the contractual clauses delivers an unreasonable result. In *Schuler A.G. v Wickman Machine Tools Sales Ltd*, Lord Reid observed that “the more unreasonable the result the more unlikely it is that the parties can have intended it”.¹⁴⁵ The view that ‘a particular construction leads to a very unreasonable result being a relevant consideration of the court’¹⁴⁶ recognises the court’s willingness to filter meaning through an objective standard they believe reflects a ‘reasonable’ interpretation and outcome. Straying too far from a ‘reasonable outcome’ led Lord Reid to ‘search for some other [less plain] meaning of the contract.’

The House of Lords case of *Investors Compensation Scheme Ltd v West Brunswick Building Society*¹⁴⁷ has become one of the most commonly cited contract law cases. It focused on utilising a contextual approach to contract interpretation. Lord Hoffmann laid down five principles as to how contracts should be interpreted. The first limb was to determine what a reasonable person, having all background knowledge, would have understood.¹⁴⁸ Lord Hoffmann, in his discussion on the role of the ‘matrix of fact’, said that it “includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.”¹⁴⁹ A later acknowledgement and further discussion of the limits to such an apparently unlimited phrase lead Lord Hoffmann to state that “absolutely anything” meant only those things a reasonable person would regard as relevant.¹⁵⁰

However, this wide ambit to interpretation has had limits placed on it by a recent Supreme Court decision in *Arnold v Britton and others*. It held that “while [interpreting] a written contract, the court must identify the intention of the parties by

¹⁴⁵ *Schuler A.G. v Wickman Machine Tool Sales Ltd* [1974] A.C. 235 (H.L.) at 251.

¹⁴⁶ *Schuler A.G.*, above n 145.

¹⁴⁷ *Investors Compensation Scheme Ltd v West Brunswick Building Society* [1998] 1 WLR 896.

¹⁴⁸ At [912-913].

¹⁴⁹ *Investors Compensation Scheme Ltd*, above n 147.

¹⁵⁰ *Bank Credit & Commerce International SA v Ali* [2001] 1 All ER 961 at 975.

reference to “what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean” with a “focus on the particular words of the contract”¹⁵¹, and placed a limit on the role of the party’s subjective intentions in the interpretation, shifting the impetus back towards the words of the contract. Although there have been limitations on the breadth of enquiry, the meaning of the words is still generated through the interpretive lens of the ‘reasonable man.’ The Supreme Court has made a concerted effort to move away from substantive fairness.¹⁵² Reliance must be placed on commercial common sense however such reliance should not undervalue the importance of the language of the provision.¹⁵³ Also, this reflects a similar sentiment to the issue of subjective honesty in the problem of practical application. The reasonable man is still the tool for interpretation, yet it is through a more limited lens, applied to the words of the contract first and foremost.

The court has also been willing to rely on the tool of the expectations of a reasonable man to implying terms into the contract. In 1889 in *The Moorcock*,¹⁵⁴ an implied term was found to be extraneous to the strict words of the contract, but was implied, as the courts believed the particular facts of the case warranted such an implication. In the renting out of a jetty, from the defendants, a ship-owner, the plaintiff, wished to unload and discharge his ship at their wharf. There was a written contract. However, there was no written undertaking for the defendants to ensure the condition of the jetty or the riverbed. As a result, during the plaintiff’s use of the jetty the boat was washed upon some hard stone below the mud of the riverbed, causing damage to the hull of the ship. An implied term to ensure the safety of the riverbed was deemed necessary to give efficacy to the intentions of each party. Thus, it was held “the law was left to raise such inferences as are reasonable from the very nature of the transaction.”¹⁵⁵

¹⁵¹ *Arnold v Britton and others* [2015] UKSC 36 at [14-15].

¹⁵² At [19-20].

¹⁵³ At [17].

¹⁵⁴ *The Moorcock* (1889) 14 PD 64, [1886-90] All ER Rep 530.

¹⁵⁵ At 534 and 536.

The court implying terms has since been moderated. *Trollope and Colls Ltd*¹⁵⁶ attempted to limit such judicial discretion, saying that it is “not enough that such a term would have been adopted by the parties as reasonable men...it must have been a term that goes without saying”.¹⁵⁷ It appears to be raising the standard for the court to imply a term, from the objective standard of the reasonable person to something more, that is, something that ‘goes without saying.’ While this statement limits the scope of when a term might be implied, it does not offer substantive interpretative guidance. In *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*,¹⁵⁸ the court attempted to alleviate any confusion by outlining five steps that would give rise to the need to imply a term into a contract:¹⁵⁹

“In their lordships view, for a term to be implied, 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; and
- (5) It must not contradict any express term of the contract.”

Lord Hoffmann provided the judgment for the Privy Council in the case of *Attorney General of Belize v Belize Telecom Ltd*,¹⁶⁰ where he said:¹⁶¹

That the courts have “no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means.”

His Lordship also went on to address the BP refinery test. He held that the ‘BP Refinery list should not necessarily be regarded as cumulative, each element is a

¹⁵⁶ *Trollope and Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 2 All ER 260 at 268.

¹⁵⁷ *Trollope and Colls Ltd*, above n 156.

¹⁵⁸ *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 16 ALR 363.

¹⁵⁹ At [40].

¹⁶⁰ *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10.

¹⁶¹ *Belize*, above n 160, at [16].

useful indication of what the reasonable person would have understood the contract to mean.’¹⁶² Further, he considered that such terms as ‘business efficacy’, and ‘so obvious it goes without saying’ are merely recreations of simply ‘what would reasonably be understood to mean’.¹⁶³ Although the standard has shifted and there have been additional substantive steps introduced to limit judicial discretion and provide greater legal certainty, the construction and implication of terms still turns on what the courts assessment of what the understanding of a reasonable person, with regard to all information available to them, would be. The court did not intend the standard to become less rigorous. The court must be satisfied that, given all available information, that is in fact what the contract actually means.¹⁶⁴ If there has been a failure to plan for a contingency, the courts may then step in to imply a reasonable term.

(ii) New Zealand

New Zealand has followed the UK in its interpretation of contractual terms. The Court of Appeal said it, “does not accept the proposition that the factual matrix is to only be considered where there is ambiguity in the terms of the contract.”¹⁶⁵ Tipping J, confirming the position in the Supreme Court, said:¹⁶⁶

“The objective approach does not require there to be an embargo on going outside the terms of the written instrument when the words in issue appear to have a plain and unambiguous meaning. This is because a meaning that may appear to the court to be plain and unambiguous, devoid of external context, may not ultimately, in context, be what a reasonable person aware of all relevant circumstances would consider the parties intended their words to mean.”

However, in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*,¹⁶⁷ the Supreme Court was called upon to determine the role of the factual matrix and pre-negotiating materials in the interpretation of contractual terms. The court had an opportunity to

¹⁶² *Belize*, above n 158, at [27].

¹⁶³ At [25].

¹⁶⁴ At [22].

¹⁶⁵ *Ansley v Prospectus Nominees Unlimited* [2004] 2 NZLR 590 CA at [36].

¹⁶⁶ *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [22].

¹⁶⁷ *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147.

alter the effect of Lord Hoffmann's statement on the expansive breadth of enquiry that might inform contract interpretation. The court had hinted at limiting the scope of this ruling in the manner of the recent English decision in *Arnold v Britton and others*. However, the issue was left largely unresolved as the document in question was determined to be relevant to the contract as a means of premium calculation with respect to the original policy certificate that is consistent across all policies rather than as pre-negotiation material.

In *Hickman v Turn*,¹⁶⁸ New Zealand has followed the UK's position in *Belize*. As in the UK, New Zealand also uses the reasonable expectations and the reasonable man test as the lens through which terms are implied. New Zealand and the UK are aligned in the existence and scope of the reasonable man in contract interpretation, construction, and the implication of terms. Thus, while the courts in New Zealand and the UK are intent on limiting the role of the factual matrix in the interpretation of contract, the reasonable man will still play an important role in construing the meaning of the contractual terms.

(iii) Canada

The Canadian courts have indicated that giving effect to the expectations of reasonable parties is the central focus of contract law. The courts believe that the implication of the new organising principle of good faith together with the duty of honesty "will put in place a duty that is just, that accords with the reasonable expectations of commercial parties and that is sufficiently precise that it will enhance rather than detract from commercial certainty."¹⁶⁹ The development of these new doctrines has focused on the expectations of reasonable parties. In the ground-breaking case of *Bhasin* the court was attempting to "bring the law closer to what reasonable commercial parties would expect it to be." Thus, as in the UK, the reasonable man is still actively employed. Aligning contractual outcomes with the expectations of reasonable parties has been a central focus across the common law world for over a century.

¹⁶⁸ *Hickman v Turn and Wave Ltd* [2011] NZCA 100.

¹⁶⁹ *Bhasin*, above n 1, at [34].

(iv) Australia

Australia has developed the most overlap between enforcing reasonable expectations and recognising good faith obligations, proceeding “on the assumption that there may be implied, as legal incidence of a commercial contract, terms of good faith and reasonableness.”¹⁷⁰ In *Far Horizons Pty Ltd v McDonalds Australia Ltd*,¹⁷¹ dealing with the provisions of licencing agreements, the court implied a term of good faith and fair dealing, requiring each party to exercise their powers under the agreement in good faith, and reasonably.¹⁷² However, the court in Australia has drawn no distinction between an implied term of reasonableness and that of good faith.¹⁷³

Opposition to an understanding of good faith that includes reasonableness is based on the new understanding that these terms are not homogenous or interchangeable.¹⁷⁴ Incorporating the tools pertaining to reasonableness would generate a doctrine of good faith that is too broad, and would facilitate an unnecessary expansion of judicial discretion. In *First City Corporations Ltd v Downside Nominees Ltd*, a receiver who was acting in good faith could still have been negligent and therefore found to be acting unreasonably.¹⁷⁵ Whilst these are valid concerns, some element of reasonable conduct must nonetheless be included in the definition of good faith. Good faith should not be equated merely with the concept of reasonableness, because the doctrine then becomes overly broad and may not provide adequate legal certainty.

Rather, reasonableness should operate to temper the requirements of honesty and co-operation, and to ensure that the doctrine operates fairly. In seeking to uphold co-operation and honesty, the courts will only apply a standard that they believe to be reasonable. This aspect of the doctrine means that contractual performance does not become so onerous as to discourage commerce. An inclusion of reasonableness as the third limb of good faith ensures that the concept does not expand into a fiduciary obligation, something critics are wary of. Rather, it allows honesty and co-operation to be upheld to a level that is appropriate to the contractual dealing and the particular

¹⁷⁰ *Burger King*, above n 1, at [159].

¹⁷¹ *Far Horizons Pty Ltd v McDonalds Australia Ltd* [2000] VSC 310.

¹⁷² At [120].

¹⁷³ *Renard*, above n 133, at 263.

¹⁷⁴ *Bayley*, above n 94, at 110.

¹⁷⁵ *First City Corporations Ltd v Downside Nominees Ltd* [1989] 3 NZLR 710, at 742.

relationship. Reasonable expectations are paramount to the purposes of the good faith doctrine.¹⁷⁶ The third limb of the working definition of good faith, namely reasonableness, ensures that the bounds of good faith remain constrained, and that the judiciary does not dispense their own “palm tree style justice.”¹⁷⁷

3.5 A stand-alone doctrine of good faith?

As I have outlined, each of the three aspects of the working definition of good faith are already active within the common law. Although there is no consensus as to the meaning and scope of good faith, none of the terms I have set out comprising the concept are new. Further, these concepts are not met with the same level of opposition as good faith is when it is conceptualised as a stand-alone doctrine.¹⁷⁸

Yet, given that the three limbs are each regularly applied within the common law, it is arguable that a general duty of good faith is in fact developing. Increased attention has been paid to the notion of good faith,¹⁷⁹ but there is still a reluctance to recognise it as a general standalone duty. There is concern of a lack of legal certainty. Further, such an obligation could be perceived as a form of fiduciary obligation that would remove the ability for commercial parties to freely pursue their own interests. An important aspect of the definition of good faith utilised within this dissertation is that it does not preclude a party from acting in self-interest.¹⁸⁰ It only requires that regard for the reasonable expectations of the other party be taken into account,¹⁸¹ invoking a certain ‘neighbourhood responsibility’.¹⁸²

The working definition I have set out encompasses three inter-related notions and duties. These three duties seek to bring certainty, clarity, and give effect to the reasonable expectations of parties. Co-operation, honesty and reasonable expectations already exist as independent duties in the common law, as do a number of other

¹⁷⁶ *Bayley*. Above n 94, at 113.

¹⁷⁷ *Bahsin*, above n 1, at [70].

¹⁷⁸ *Bayley*, above n 94, at 114, and Justin Smith, “‘Good Faith’ in, *The Law of Obligations – Contracts in Context*” (New Zealand Law Society Intensive, 2007) at 34.

¹⁷⁹ *Yam Seng*, above n 1.

¹⁸⁰ Justice Paul Finn “*Good Faith and Fair Dealing: Australia*” [2005] 11 New Zealand Business Law Quarterly 378 at 381.

¹⁸¹ *Bayley* n 94, at 101.

¹⁸² *Finn*, above n 180, at 382.

equitable doctrines with similar underlying sentiments.¹⁸³ Perhaps then, the law is closer to accepting a duty of good faith than some commentators care to admit. If this working definition is accepted, the criticisms that good faith lacks commercial and legal certainty and that good faith does not fit well within the self-interested notions of our law¹⁸⁴ begin to lose significance.

¹⁸³ There are a number contractual doctrines that restrict individual autonomy and seek to encourage commercial fairness: misrepresentation, unconscionable bargains, estoppel, and undue Influence.

¹⁸⁴ *Davies*, n 7.

Chapter 4: Some remaining criticisms and responses to good faith

Three main issues can be identified as reasons for the entrenched hostility towards a doctrine of good faith reflected in the common law: first, the staunch pursuit of freedom of contract reflects a preference for autonomy and the facilitation of the pursuit of self-interest; second, the failure of good faith to align with the common law's preference for incremental development, reflecting an appreciation of its inherently conservative nature, resulting in too much legal uncertainty.¹⁸⁵ Finally, the failure to provide a definition of good faith blurs commercial distinctions and obligations and has a negative impact on the commercial certainty and economic interests. In this final chapter I will engage with these criticisms and attempt to argue that they are not as persuasive as they may originally appear.

In the previous chapters, I have sought to provide some descriptive information regarding good faith, whilst also analyzing its current standing in the law. Through this discussion, I have sought to subtly refute some of the major criticisms relating to the existence of a duty of good faith. For example, the second chapter of this dissertation discussed the existence of good faith in the current common law climate and specific aspects of New Zealand's law. The development of a general principle of good faith, such as in Canada, appears in this light to be consistent with the law's conservative nature, by moving in incremental steps.¹⁸⁶ The third chapter provided a working definition of good faith, and broke it into three separate component duties in order to examine their current role in the law. This exploration confirmed that each aspect already operates to varying degrees in a number of major common law jurisdictions. This chapter sought to dispel the criticism that good faith is unworkably vague by demonstrating that in practical terms, elements of the definition are already implemented by the courts. The imposition of an implied term of good faith would not be revolutionary, unworkably abstract or uncertain, or the result of improper common law development.¹⁸⁷

¹⁸⁵ *Yam Seng*, above n 1, at [123] and *Davies*, above n 36 and Ewan McKendrick "Contract Law" (9th Edition, Palgrave Macmillan Law Masters, England) at 221-222.

¹⁸⁶ It is consistent with the development of other contractual doctrines such as unconscionably and estoppel, while it also shares similarity to the discourse surrounding the nature and expansion of fiduciary relationships.

¹⁸⁷ *Davies*, above n 7.

4.1 Freedom of Contract

The classical theory of contract law was the predominant theory of law through the 19th and the beginning of the 20th centuries. It did not accommodate a duty of good faith or countenance the imposition of external standards upon an individual. This theory was focused on the fostering of freedom based upon the centrality of the individual, the value of individual autonomy and the freedom to exercise creative power without the unjustified intervention by the courts and state.¹⁸⁸ Thomas J in *Bobux Marketing Limited*¹⁸⁹ noted that such an attitude had not always existed. As he explained, Lord Mansfield in 1766 had proclaimed a description of good faith as “the governing principle...applicable to all contracts and dealings.”¹⁹⁰ Thomas J saw Lord Mansfield’s vision as “swamped by a law reflecting the laissez-faire economics and liberal individualistic theories of the nineteenth century.”¹⁹¹ This attitude was captured in the oft-cited case of *Printing and Numerical Registering Co v Sampson*,¹⁹² where Sir George Jessel MR said:

“If there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract.”¹⁹³

The courts of England and Wales, and the commonwealth more generally, therefore developed a hostile attitude towards the imposition of any terms, good faith included, into agreements freely made by adults of sound mind. That is not to say that the individual parties themselves could not agree to operate in good faith, but rather that

¹⁸⁸ P.S Atiyah “*The Rise and Fall of Freedom of Contract*” (1979, Oxford, Clarendon Press) at 25, and Reshma Korde “*Good Faith and Freedom of Contract*” [2000] UCL Jurisprudence review.

¹⁸⁸ *Bobux*, above n 16 at [34].

¹⁸⁹ At [34].

¹⁹⁰ *Carter v Boehm* 97 ER 1162 at 1164 and also *Mellish v. Motteux* (1792) Peake 156 at 157 where Lord Kenyon said “In contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith”.

¹⁹¹ *Bobux*, above n 16.

¹⁹² *Printing and Numerical Registering Co v Sampson* (1875) 19 Eq 462.

¹⁹³ At [65].

the courts would not impose such a standard if it fell beyond the word of the agreement. The classical theory of contract was seen to offer predictability and certainty. As such, a prospective doctrine of good faith was, and at times still is, met with criticisms on the basis that it presents an unjustified restriction on the freedom of the individual and lacks the requisite certainty that classical contract law demanded. However, over the 20th century the dominant legal and political paradigm began to shift and, as Mason observed, “it later emerged that, as is the case with many concepts rooted in legal formalism, the element of certainty was illusory.”¹⁹⁴

The strength of the classical theory of contract law, and its obsession with the right of the individual and their freedom to draw contracts as they wished, began to weaken. Lord Denning’s judgment passed in *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*¹⁹⁵ reflects this shift. The case concerned the sale of seed for cabbage to an arable crop farmer. The agreement included a term on the invoice to limit and exclude the liability for ‘any plants or seeds sold.’ Lord Denning provided a dissenting judgment. The majority held that the exclusion clause could not operate because what was supplied was not in fact seed. The clause excluding and limiting liability had no effect. However, Lord Denning denied the clause’s validity under the Supply of Goods (Implied Terms) Act 1973 on the basis that the clause was unreasonable. Lord Denning also commented on the shifting standards imposed by the judiciary upon the express terms of contracts. His last judgment outlined this problem and illuminated the obsession with freedom of contract in the following fascinating passage:¹⁹⁶

“*The heyday of freedom of contract*

None of you nowadays will remember the trouble we had - when I was called to the Bar - with exemption clauses... They were held to be binding on any person who took them without objection. No one ever did object. He never read them or knew what was in them. No matter how unreasonable they were, he was bound. All this was done in the name of "freedom of contract."... It was a bleak winter for our law of contract...¹⁹⁷”

¹⁹⁴ Mason, above n 84, at 70.

¹⁹⁵ *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] (QB) 284.

¹⁹⁶ At 297.

¹⁹⁷ Lord Denning cited both *Thompson v London, Midland and Scottish Railway Co* [1930] 1 KB 41, in which there was exemption from liability, not on the ticket, but only in small print at the back of the timetable, and the company was held not liable, and *L'Estrange v F*

And he continued:¹⁹⁸

“The secret weapon

Faced with this abuse of power - by the strong against the weak - by the use of the small print of the conditions - the judges did what they could to put a curb upon it. They still had before them the idol, "freedom of contract." They still knelt down and worshipped it, but they concealed under their cloaks a secret weapon. They used it to stab the idol in the back. This weapon was called "the true construction of the contract."... They used it so as to depart from the natural meaning of the words of the exemption clause and to put upon them a strained and unnatural construction... In short, whenever the wide words - in their natural meaning - would give rise to an unreasonable result, the judges either rejected them as repugnant to the main purpose of the contract, or else cut them down to size in order to produce a reasonable result.”

The House of Lords upheld the judgment of Lord Denning in holding that the limitations on the liability to only cover the cost of the seed were ineffective. As a result of the respective insurance schemes, the limitation of liability was held to breach the reasonableness test.¹⁹⁹ The language and style of the judgment clearly identifies the polarised opinion that had developed within the judiciary with respect to the issue.

A further common criticism that arises in relation to good faith represents an unjustified limitation on freedom of contract. However the force of this criticism may also be exaggerated. I point to the number of existing contractual doctrines that have limited the ability of the individual to incorporate contractual terms as they might wish. These restrictions have not been met with the same ferocity and disagreement that an implied the term of good faith generates.

(i) Accepted limitations to freedom of contract:

Graucob Ltd [1934] 2 KB 394, in which there was complete exemption in small print at the bottom of the order form, and the company were held not liable, as examples of the bleak winter faced by contract law.

¹⁹⁸ *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*, above n 143, at [297].

¹⁹⁹ *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 1 All ER 737 (HL).

In the past, contract law was limited to rules of formation, and formal indicators of legitimacy that required satisfaction before a contract would be enforced. However, the substantive obligations established by the contract were left to the parties to determine themselves. While there have always been some inherent inconsistencies²⁰⁰ between principles of contract law and freedom of contract, the 20th and 21st centuries saw an increased legislative and judicial interventionism that began to undermine the doctrine of the classical theory of contract law.²⁰¹ Much like the case of good faith, there have been opponents to such developments. It is beyond the scope of this dissertation to consider whether there should be limits imposed on individual autonomy in the following cases. Rather, the examples discussed reflect that the common law has become increasingly willing to impose restrictions on individuals when it considers this to be necessary.

I now turn to discuss commonly referenced tools that are utilised by the courts, which are in conflict with the principle of freedom of contract. The doctrines of unconscionability and estoppel are existing restrictions on the freedom of contract that are not without their detractors. Their inclusion and evolution have not been met with the same level of fervent disagreement as good faith, although they also impose standards upon the individual that restrict personal developments touching on freedom and autonomy.

Unconscionable bargain was a ground for relief limited to persons suffering from special disability or disadvantage, or those incapable in the view of the court of forming a rational judgment. Unconscionability then began to be applied more broadly; for example, where one party takes advantage of an inferior bargaining position and procures or retains the benefit in a way that is both unreasonable and oppressive. The courts have viewed such behaviour as inappropriate.²⁰²

²⁰⁰ Consideration, being something given or pledged in exchange for a promise, is an element necessary to form a legally enforceable contract. This requirement is often seen as an intrusion on individual liberty. Yet the law finds that for a promise to be legally binding, there must be consideration, and without consideration, a promise or contract is not binding.

²⁰¹ Donal Nolan *"The Classical Legacy and Modern English Contract Law"* (1996) *The Modern Law Review* 59 at 612.

²⁰² *K v K* [1976] 2 NZLR 31 incorporated the decision of *Morrison v Coast Finance Ltd* (1965) 55 DLR (2d) 710 (BC:CA) in which Lord Denning discussed the courts willingness to intervene in situations of duress, undue influence, undue pressure, unfair

New Zealand has utilised unconscionable bargains as an equitable ground where a poor or ignorant person acting without independent advice in a transaction formed an agreement that is not fair or reasonable.²⁰³ An element of unconscionability is present if the nature of the bargain is such that if a person is explained the facts, they could not, in conscience, take the bargain.²⁰⁴ The courts have broadened the scope of the ground with respect to timing. It was held that an unconscionable bargain arose at the point of passive acceptance, not the point of formal agreement.²⁰⁵ For example, in the sale and purchase of property, it is the time when terms are bargained for not when the contract becomes unconditional that the question of unconscionability should be asked. Thus, the courts have extended the bounds of examination from the formation of the crystallised contract to the timing of the passive assignment of contractual rights.²⁰⁶

The doctrine of unconscionability has faced criticisms similar to those leveled at a doctrine of good faith. It reflects the balance between the need for certainty in commercial affairs and the need to avoid behaviour that is unacceptable to the community. Thus, equity will intervene to deprive parties of their contractual rights where they have unconscionably obtained benefits or have accepted benefits in unconscionable circumstances.²⁰⁷ Such an approach is in tension with a strict application of freedom of contract.

Secondly, estoppel has seen substantial development in recent years and has also been equated with an underlying rationale of good conscience and fair dealing.²⁰⁸ Estoppel is often described as “prevent[ing] an unjust departure of one person from an assumption adopted by another.”²⁰⁹ Australia has seen, in a similar vein to the approach taken to good faith, an expansive liberalisation of the role of estoppel.²¹⁰ New Zealand has not taken as liberal an approach, but there has certainly been an

advantage, and maritime salvage as a result of the inequality of bargaining power between the parties.

²⁰³ *O'Connor v Hart* [1985] 1 NZLR 159.

²⁰⁴ *Contractors Bonding Ltd v Snee* [1992] 2 NZLR 157 (CA).

²⁰⁵ *Gustav & Co Ltd v Macfield Ltd* [2008] NZSC 47.

²⁰⁶ At [7].

²⁰⁷ *Contractors Bonding*, above n 182, at 174.

²⁰⁸ *Mason*, above n 86, at 13.

²⁰⁹ *Grundt v Great Boulder Pty Gold LQR 92 Mines Ltd* (1937) 59 C.L.R. 641 at 674-677.

²¹⁰ *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387.

expansion of the doctrine.²¹¹ Holland J, delivering the Court of Appeal's judgment in *Gold Star Insurance Co Ltd v Gaunt*,²¹² went so far as to say that "any suggestion that estoppel is available only as a shield has disappeared." Moreover, the New Zealand courts have now confirmed the test of detrimental reliance as the basis to enforce a non-contractual promise, and held that relief for such a promise now extends beyond the previous limitation of monetary damages to enforcement of the promise itself.²¹³ Thus, the courts have utilised and expanded the role of estoppel as a means of achieving fair outcomes. The pursuit of fairness through estoppel reflects a willingness on the part of the courts to compromise the notion of individual autonomy and freedom of contract where they believe it is reasonable to do so.

(ii) Why not good faith?

The criticism that good faith limits freedom of contract carries some weight. However, the law is rife with examples of restrictions on freedom of contract. These restrictions are not novel and the disdain directed toward good faith by the common law arguably represents a disproportionate response to such concerns. English courts provide the quintessential example of the development of the common law. They have been energetic in their rejection of a broad doctrine of good faith, treating it like 'a contagious disease of alien origin'.²¹⁴ A leading Canadian contracts scholar went so far as to say that the common law has taken a "kind of perverted pride" in the absence of any general notion of good faith, as if accepting that such a notion "would be admitting to the presence of some kind of embarrassing social disease."²¹⁵

Moreover, there appears to be an emphasis in these arguments on a negative conception of freedom. However, historically, the idea of freedom of contract has had a dual meaning.²¹⁶ Isaiah Berlin distinguished between positive and negative aspects of freedom. The positive aspect of freedom refers to an individual's ability to be creative and participate in a contractual process that maximises the abilities of both

²¹¹ *Krukziener v Hanover Finance Ltd* [2010] NZAR 307 at [38].

²¹² *Gold Star Insurance Co Ltd v Gaunt* [1998] 3 NZLR 80 at 102 and 299.

²¹³ *Wilson Parking New Zealand Limited v Fanshawe 136 Limited* [2014] NZCA 407.

²¹⁴ G. teubner "Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies" (1998) *Modern Law Review* 61.

²¹⁵ J. Swan "Whither Contracts: A Retrospective and Prospective Overview", in *Special Lectures of the Law Society of Upper Canada 1984 — Law in Transition: Contracts* (1984) 125 at 148.

²¹⁶ Reshma Korde "Good Faith and Freedom of Contract" [2000] *UCL Jurisprudence review*.

parties. The negative dimension of freedom entails the denial of any obligation unless it is explicitly consented to.²¹⁷ Both conceptions underlie large swathes of contract law doctrines still in operation today. The dominant attitude is that a contract is a voluntary assumption of obligations, and thus legal institutions ought to be facilitative rather than coercive.²¹⁸ This common view has generated a skewed bias towards a more negative conception of freedom and suspicion of good faith.

By contrast, civil law nations recognised that good faith *is* a reasonable restriction upon the freedom of contract and the liberty of an individual. In these jurisdictions, the ability to contract freely is not seen as infinite. Instead, it is a right that is executed under conditions of honesty and according to the reasonable expectations of those being contracted with. Thus, there is freedom to contract in good faith, or freedom not to contract at all.²¹⁹

A period of common law focus on a negative view of freedom resulted in a reluctance by the courts to impose any obligation that was outside the construction of the words of the contract. The courts would only look to imply meaning outside the written document when the agreement itself was unworkably vague, or left gaps giving rise to competing interpretations. In the construction of meaning and judicial gap-filling terms could not be implied simply because this would lead to the most just or fair outcome. Rather, such terms were implied to give effect to the ascertained intentions of the parties involved.

While a doctrine of good faith may lead to some limits on the liberty of the individual, the limits are not as restrictive as opponents to the doctrine might suggest. Any restrictions would only be partial. A general doctrine of good faith would not undermine appropriately worded clauses that outline a desire to exclude good faith. The courts are not willing to imply a term into a contract that conflicts with an existing express term.²²⁰ Even as the common law approaches recognition of an implied obligation of good faith, it would not override the express provisions as agreed by the parties. Every case depends to a significant extent on the intention of

²¹⁷ Isaiah Berlin “*Liberty*” in Isaiah Berlin *Four Essays on Liberty* (Oxford, Oxford University Press, 1969) at 118.

²¹⁸ *Nolan*, above n 201.

²¹⁹ *Powers*, above n 39.

²²⁰ *Bhasin*, above n 1, at [28].

the parties as expressed in the contractual clauses.²²¹

There may be merit in promoting a general doctrine of good faith that would impose standards external to the intentions of the parties to a contract. The classical theory of contract law is no longer the predominant theory;²²² there has been an extension of other contractual doctrines and grounds for claim, such that the court now regards as reasonable a number of restrictions on an individual's freedom to contract.

4.2 Notions of Individuality

A second criticism, aligned to the issue of freedom of contract, is that good faith is in conflict with self-interest and the ethos of the individual. The rise and fall of the centrality of the individual may reflect changing political preferences rather than an inherent foundational notion within the common law. Whatever the reason, the pendulum has been moving away from the placement of disproportionate weight on the individual. Commentators suggest that there is a void in our law,²²³ and a number of doctrines have been adapted to try and fill this perceived void. These include a notion of community, with the court pursuing 'just' outcomes and espousing neighborhood principles.

A number of other duties that have shifted the focus of the courts away from the individual. The fiduciary principle has developed as a means of delivering more fair and just dealings in commerce.²²⁴ 'It recasts contract to abandon the arm's length perspective from which the contract was made in favour of an open-ended obligation of loyalty in favour of the promisee'.²²⁵ Arguments are made that adopt the idea of constructive trust over the subsequent profit from resale, in the case of the sale of

²²¹ *Secured Income Real Estate (Australia) Ltd v. St Martins Investments Pty. Ltd* (1979) 144 C.L.R. at 607-608.

²²² A number of theories exist to explain contractual interaction and the role of the law within those interactions. There is the classical theory, efficiency theory, and a relational theory of contract law as espoused by Ian Macneil.

²²³ Bobux, above n 16 at [48].

²²⁴ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 C.L.R. 41 and *AC Minerals Ltd v International Corona Resources Ltd* (1989) 61 D.L.R. (4th) 14 and *Liggett v. Kensington* [1993] 1 N.Z.L.R. 257 where a bullion trader keeping bullion in safe custody on behalf of purchasers was held to be a fiduciary reversed on appeal *In re Gold Corp. Exchange Ltd* [1995] 1 A.C. 75.

²²⁵ Markovits, Daniel "Theories of the Common Law of Contracts", (The Stanford Encyclopedia of Philosophy Fall 2015 Edition), Edward N. Zalta (ed.) <<http://plato.stanford.edu/archives/fall2015/entries/contracts-theories>>.

land.²²⁶ In a commercial setting, these developments have been resisted in the UK and, to a lesser extent, Australia and New Zealand on the basis that it would be undesirable that such a standard should apply to commercial transactions. The fiduciary principle imposes a higher standard than the doctrine of good faith, giving primacy to the party to whom the fiduciary obligation is owed.

Commercial endeavours call for balance between an individual's exposure to risk and enjoyment of rewards. A fiduciary obligation separates the issue of risk and reward by ensuring a person subordinates their interests to the legitimate interests of another person. Such a requirement reduces risk (and potential growth). This, in turn, affects the behaviour of commercial actors and causes confusion,²²⁷ perhaps dampening natural instincts.²²⁸ As the vast majority of contractual relationships move away from the model of parties standing at arms-length, facilitating discrete transactions, toward a concept of relationship built upon notions of continuity, there will be cases where the essentials of the fiduciary relationship emerge.²²⁹ This is a spectrum upon which a number of obligations lie. At one end is the notion of pure self-interest, and at the other the fiduciary obligation. The grey area in the middle is what Thomas J was referring to as the void that good faith would assist in filling.²³⁰

Good faith would be an effective benchmark to illuminate the middle of the spectrum and clarify a complex and troublesome area of the common law.²³¹ Arguably, it would better serve commerce by recognising the underlying necessary imperative of mutual trust and confidence, without affecting fundamental commercial issues such as

²²⁶ *Gassner v. Lockett* 101 So. 2d 33 (1958).

²²⁷ *Davies*, above n 7.

²²⁸ The entrepreneur does not intend to benefit society, according to Adam Smith, 'he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention (directing industry in such a manner that its produce may be of the greatest value)." And when they speak of self-interest, they usually have in mind a person who seeks an economic advantage. Moral commentators such as Thomas Aquinas and modern law have approved the quest for this advantage. Thomas Aquinas approved it because in these situations seeking an economic advantage was beneficial to the individual, if he acted with the right intention, as well as to the society, and it entailed no injustice. People enter into contracts, each trying to obtain something of more worth to him personally than what he gives up. It is argued that the law of contract is instituted so that people can do so. James Gordley "*Good Faith and Profit Maximisation*" University of California, Berkeley
<<http://www.stthomas.edu/media/catholicstudies/center/johnaryaninstitute/conferences/1997-antwerp/Gordley.pdf>>.

²²⁹ Mason, above n 86, at 10.

²³⁰ *Bobux*, above n 16, at [48].

²³¹ *Bhasin*, above n 1, at [40].

individual incentive.

The pendulum has begun to swing back such that the centrality of individual autonomy is not what it once was. The common law has responded but in a piece meal, incremental manner. To address this, an implied duty of good faith could clarify peoples' expectations and fill the void of societal expectation, but leaving the power with the individual to contract out of good faith and record their intentions if they wish.

4.3 Loss of Certainty:

A further main criticism directed at a general duty of good faith in contract is the apparent loss of certainty that results. The criticism is two-fold: imposing a good faith standard would damage the legal certainty²³² concerning what the law now requires of its commercial entities, and as a result such an obligation would also be detrimental upon the commercial certainty²³³ of businesses utilising contracts as a mechanism for trade.

(i) Loss of legal certainty

Too much judicial discretion

The increased, or, as some critics view it, unconstrained, judicial discretion that good faith is seen to import is a major concern of opponents to the development of such a doctrine. They consider that such a legally imposed obligation of good faith would allow for the pursuit of 'ad-hoc judicial moralism' and 'palm tree' justice.²³⁴ These are legitimate concerns that go to the heart of the role of the judiciary. A robust judicial system requires some form of accountability, and an inherent objectivity. The law of contract has refocused on a "real concern with substantive fairness".²³⁵ Critics are concerned that the application of such amorphous and abstract standards will fail to provide individuals with the security and certainty required to enable them to properly order their affairs. As long as good faith is associated with such a broad concept as fairness, such criticism is likely to continue.

However, generating 'substantive fairness' - in simple terms that the person

²³² *Yam Seng*, above n 1, at [123].

²³³ *Bhasin*, above n 1, at [79].

²³⁴ *Bhasin*, above n 1, at [79] and [70].

²³⁵ P.S Atiyah, "Contract and Fair Exchange" (1985) 35 U. Toronto L.J. 1at p. 17.

perceived to be in the wrong receives his just dessert and the party who appears to have been taken advantage of has their position rectified – regardless of what was agreed, and regardless of the circumstances, should not be the sole focus of a duty of good faith. The issue requires clarification. The definition and role of good faith appear to be more comprehensive than that of ‘substantive fairness’ and there is a distinction to be drawn between outcome and process.²³⁶ The role of the working definition of good faith is not to ensure that every ‘unfair’ outcome has a basis upon which judicial intervention can be sought. Rather, seeks to establish a clear process to manage contractual relationships. In this manner, when the focus of good faith shifts from a broad concept seeking to right all contractual wrongs, to one that is defined by reference to a benchmark, the criticism of uncertainty is in large measure addressed.

Further, the working definition of good faith upon which this dissertation is based, does not preclude a harsh outcome for one or other of the contracting parties. As Venning J noted in *Topline International Ltd v Cellular Improvements Ltd*,²³⁷ good faith does not require that each party only act in their common interests. This idea was taken further in *Bhasin v Hrynew* by Cromwell J, who stated that “in commerce a party may sometimes cause loss to another – even intentionally – in the legitimate pursuit of economic self interest”²³⁸ and that “doing so is not necessarily contrary to good faith and in some cases has actually been encouraged by the courts on the basis of economic efficiency.”²³⁹

If a definition of contracting in good faith, similar to that proposed herein, is developed by the courts, it is unlikely to conflict with legal certainty in the manner that some may suggest. Rather, the strict standards of honesty and co-operation are softened through the tool of reasonableness, which allows for a more practical and fair application of the duty. This, in turn, establishes greater certainty for contracting parties.

²³⁶ Gordley, above n 228.

²³⁷ *Topline International Ltd v Cellular Improvements Ltd* (High Court, Auckland, CP 144-SW02, 17 March 2003), at [103].

²³⁸ *Bhasin*, above n 1, at [70].

²³⁹ *Bhasin*, above n 1, and *Bank of America Canada v Mutual Trust Co* 2002 SCC 43, [2002] S.C.R 601 at [31].

Improper mode of Common Law Development

Some critics suggest that adopting an implied duty to act in good faith is not consistent with judicial utterances or proper common law development.²⁴⁰ It is suggested that common law should instead develop through two mechanisms: legitimate processes of legal reasoning, and the moulding of the law by the judiciary to fit contemporary community standards, values and expectations.²⁴¹ Critics of good faith are often aligned with libertarianism²⁴² which emphasizes individual autonomy and self-determination under the law and beyond. Obligations of good faith run contrary to this.

I have previously identified that good faith within the common law of contract is not a revolutionary approach to legal reasoning; in fact, the law has continually made reference to this concept. In addition, existing doctrines such as unconscionability and estoppel are grounded in concepts of fairness and offer a recognized common law response to injustice in particular cases. I have discussed the fact that the limbs of the working definition already operate independently throughout the common law. Further examples of legislatively imposed good faith can be found both internationally and domestically, and good faith is recognized in the common law through judicial reasoning.

Indeed, the Canadian Supreme Court in the trail blazing judgment of *Bhasin* effectively rejected this criticism, by adopting “the organizing principle of good faith [which] has been consistent with the case [development] of unjust enrichment.”²⁴³ Further, the court recognized that a “general duty of good faith would constitute an incremental advance in the law, given the numerous specific situations that already give rise to a duty of good faith.”²⁴⁴ To suggest that good faith does not follow a legitimate process of legal reasoning cannot be correct. Good faith, historically, was a

²⁴⁰ *Davies*, above n 7.

²⁴¹ Alastair MacAdam and John Pyke “*Judicial Reasoning and the Doctrine of Precedent in Australia*” (Butterworths, 1998) and Sir Robin Cooke, “*Fairness*” (1989) 19 Victoria University of Wellington Law Review 421 and Mr Justice Thomas “*Fairness and Certainty in Adjudication: Formalism v Substantialism*” (1999) 9(3) *Otago Law Review* 459.

²⁴² Libertarianism is a political philosophy that upholds liberty as its principal objective. Libertarians seek to maximize autonomy and freedom of choice, emphasizing political freedom, voluntary association, and the primacy of an individual’s judgment.

²⁴³ *Bhasin*, above n 1, at [67].

²⁴⁴ At [29].

“governing principle...applicable to all contracts and dealings”.²⁴⁵

Community standards are difficult to measure and efforts to do so – for example, through surveys – often reflect deep biases. However, there is a case to be made that the law could, indeed should, mould itself to better reflect general community expectations of honesty and co-operation. The Canadian Supreme Court simply said: ‘commercial entities and individuals do in fact expect that their contracting parties will conduct themselves in good faith’.²⁴⁶ It would be unusual for commercial parties, with the same information and bargaining power, to accept a provision in a contract that in effect did not oblige each party to act honestly in the performance of their obligations.

The role and application of the working definition of good faith within the context of the law as discussed in previous chapters, does not appear to give rise to the level of legal uncertainty that critics of the concept fear. Like other legal doctrines, good faith involves matters of fact, degree and value judgment so that, to the extent necessary, guidance will come from an array of decisions determined in particular situations.²⁴⁷ This is how the common law and precedent develop, in general. On this basis, criticisms that such a definition of good faith is legally uncertain is perhaps exaggerated. As the earlier discussion of comparative case law demonstrates, common law reasoning can comfortably embrace such a concept.

(ii) Loss of commercial certainty:

a. An inconsistent critique

Two further connected criticisms that are often directed at good faith at the same time: that the law needs to remain certain and, when intervention is necessary, the law should respond in a fact specific, piece-meal way. It appears to be counterintuitive to desire certainty around obligations, yet to allow the law of contractual obligations to

²⁴⁵ *Carter v. Boehm* (1766) 3 Burr. 1905 at 1909 (97 E.R. 1162 at p. 1164) note also *Mellish v. Motteux* (1792) Peake 156 at 157 (170 E.R. 113 at pp. 113-114) where Lord Kenyon said “In contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith”.

²⁴⁶ S. Macaulay “*Non-contractual Relations in Business: A Preliminary Study*” (1963), 28 *Am. Soc. Rev.* 55 at 58 and H. Beale and T. Dugdale “*Contracts Between Businessmen: Planning and the Use of Contractual Remedies*” (1975), 2 *Brit. J. Law & Soc.* 45.

²⁴⁷ *Mason*, above n 86, at 12.

develop with all the ambiguity this entails. Commerce needs clear settled rules.²⁴⁸ The discrete nature of certain doctrines of contract law have the opposite effect. For example, commercial parties may or may not need to act under an implied obligation of good faith depending upon whether the courts deem the contractual relationship to have the requisite complexity and level of mutual reliance. Unless an agreement falls within an established class of relational contract, a dispute as to whether the behaviour of the contracting parties is appropriate remains at the discretion of the courts. Such an approach arguably leads to greater confusion and less certainty for those parties engaged in complex commercial contracts. Having a default implied term of good faith would allow commercial parties to plan accordingly, as opposed to the status quo, where the existence of a general implied obligation of good faith is denied, subject to its discretionary application by the courts. John Gava stated that ‘market players are not interested in the particular formulation of the rules as long as these rules are predictable and have some connection to transacting.’²⁴⁹ What makes a duty of good faith appropriate is that ‘it is not the reversal of some settled rule, but a development directed to bringing greater certainty and coherence to a complex and troublesome area of the common law.’²⁵⁰

Some commentators have suggested that the United States experience has shown that concepts of good faith and fair dealing have generated ambiguity and uncertainty. But as Mason recognised, even if there is a measure of truth to such statements, the experience does not appear to have been unduly detrimental to commerce in that country.²⁵¹

b. Back to the starting point:

If, notwithstanding the current law, there is a general belief that commercial entities and individuals do in fact expect that their contracting parties will conduct themselves in good faith, then contracts are in fact formed against the background assumption that parties will be honest and will co-operate with each other. The question should then become, ‘do the parties intend to be legally bound to act in good faith?’ One

²⁴⁸ R Ahdar “*Contract doctrine, predictability and the nebulous exception*” Cambridge Law Journal 73: 39-60 (2014) at 52.

²⁴⁹ John Gava “*Can Contract Law be Justified on Economic Grounds?*”(2006) 25 University of Queensland L.J. 253 at 261.

²⁵⁰ Bhasin, above n 1, at [40]

²⁵¹ Mason, above n 86, at 15.

argument is to suggest that, although contracting parties believe that each should conduct themselves in good faith, they are content that they are not legally bound by this standard of behaviour. While this explanation is possible, it is unlikely. It is difficult to contemplate a scenario where parties to an agreement would be satisfied with a term that allows for dishonest conduct. When utilising contractual relationships to plan for the future, and as a basis for all commercial endeavors, it would be reasonable to expect that the contracting parties would wish to be legally bound to act in good faith,²⁵² (recognising that such an admission would be unlikely made by a party acting in bad faith hoping to be released from a contract).

Perhaps then, the nature of the gap between the terms of the contract and the intentions of the parties to act in good faith, comes down to an issue of transaction costs. All contracts are ontologically incomplete,²⁵³ as a contract cannot provide for every possible contingency.²⁵⁴ While there is still an intention for parties to deal with each other with honesty and co-operate with each other, they have intentionally left the express term out of the contract. This may be particularly evident in agreements where one party holds the dominant economic position. It is costly to draft and include express contractual terms, especially for a party of more limited resources. In the event of such a breach, therefore, it is the court's role to fill the gaps. Although their intention was to not include an express term of good faith, it was also not their intention to allow the parties to behave in bad faith. Therefore, without an implied good faith obligation, the court could act in a manner contrary to the true intentions of the contracting parties, encouraging opportunistic behaviours²⁵⁵ which are usually a breach of good faith obligations.

Without an express or implied term of good faith, and with contractual benefits appropriately assigned, contracting parties may be subject to a temptation to breach

²⁵² This would also have similarities with the arguments proposed by John Rawls in his thought experiment involving the veil of ignorance. The veil of ignorance is part of a long tradition of thinking in terms of social contract theories. The idea of the thought experiment is to render obsolete those personal considerations that are morally irrelevant to the justice or injustice of principles meant to allocate the benefits of social cooperation.

²⁵³ Bayley, above n 94, at 231.

²⁵⁴ Alan Schwartz "Legal Contract Theories and Incomplete Contracts" (Yale Law School, Faculty Scholarship series, Paper 313, 2000)
<http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1312&context=fss_papers> at 80.

²⁵⁵ Perhaps a more meaningful and economic definition of opportunistic behaviour is conduct that seeks to redistribute contractual benefits that have already been allocated.

the terms of their contract as a result of moral hazard.²⁵⁶ For example, where a party may be dishonest about the nature of the relationship, using their existing contract as a means of leverage into a more beneficial agreement with a third party. There is little risk in such behaviour, because there is no contractual breach without a duty of good faith. This is similar to the outcome in *Bhasin v Hyrnew*, where Cam-Am were able to court and generate a better outcome, all the while dishonestly maintaining their existing relationship. In commercial situations such as international supply of goods, communication is electronic. Each party relies on the other to protect their good will. There is no face to face contact and markets are globalized. Commercial players might in such circumstances take advantage and damage the good will of another by producing and selling poorer quality ‘dummie’ goods, without the affected party being aware.²⁵⁷ Without a duty of good faith, such opportunistic behaviour is not restrained.

The likelihood of one party changing their behaviour as a result of a contract is unknown to the other party. The probability of moral hazard generates an issue of asymmetric information. Such a problem is the very issue that led to insurance contracts being distinguished as *ubermait fides* – of utmost good faith. The market does allow for information about commercial parties to be diffused through reputation and market indicators. However, the court can provide a basis of a claim in good faith that would deter acting opportunistically and contrary to good faith. A duty of good faith would limit the pertinence of information asymmetries in contractual performance, and would remove the pervasive effect of moral hazard.

²⁵⁶ Moral hazard occurs when one person takes more risks because someone else bears the burden of those risks. A moral hazard may occur where the actions of one party may change to the detriment of another after a financial transaction has taken place.

²⁵⁷ *Bobux*, above n 16.

Chapter 5: Concluding remarks

This second chapter of this dissertation focused on the current status of good faith in the common law jurisdictions and in specific contexts in New Zealand law. It found that while numerous jurisdictions and legal contexts utilise the concept of good faith, such applications often embrace its ambiguous nature. Both common and civil law traditions reflect deep roots²⁵⁸ of good faith. The common law initially utilised good faith as a general excluder of sorts, but has started approaching the concept in more positive terms. New Zealand has largely followed a sceptical approach to good faith obligations. However, employment contracts have applied more onerous terms through the Employment Relations Act. Insurance also entails contracts with an expectation of good faith, which encompasses a duty of disclosure. Express terms of good faith were seen as excluding behaviours of bad faith but have begun to move in closer alignment with the Australian expectation. While these distinct jurisdictions and legal contexts have adopted ranging approaches to the duty, its meaning and application sit upon a number of shared concrete principles. Parties are expected to be honest with each other, to co-operate to achieve the purposes of the contract and to behave in a reasonable fashion with regard to the other party, the relationship, and the aims of the contract.

The third chapter provided a working definition of good faith and explored the role of each of its three separate components in the common law.²⁵⁹ The major courts in the Commonwealth have applied each limb to differing extents. There is a strong position taken by the courts requiring parties to be honest. Australia has applied a duty of co-operation as a legal incidence of any form of contract while England and New Zealand have looked to imply a term of co-operation where it is deemed to be necessary. Intuitively, it is hard to imagine a case where the courts would appreciate the need for parties to be uncooperative in a contractual relationship. Finally, the courts interpret, and imply terms in a contract using the tool of the reasonableness. While each of the three limbs exist in the common law, when incorporated as part of a general obligation of good faith, these concepts face significant opposition and push-back.

²⁵⁸ *Bhasin*, above n 1, at [32].

²⁵⁹ The three limbs are honesty, co-operation, and reasonableness.

Finally, the fourth chapter engaged with the three main criticisms directed at an implied term of good faith: the ethos of individuality and its relationship to the classical theory of contract law, and the concern around increased legal and commercial uncertainty. There is much more that can be said both for and against implying a general term of good faith, but this discussion falls beyond the scope of this dissertation. The final chapter identifies that there are valid criticisms of such an approach to good faith. While the examination and rebuttals to such criticisms in this chapter are brief, it presents the argument that such criticisms are often exaggerated.

I would suggest that much criticism flows from the lack of a crystallised legal definition of a duty of good faith. The Canadian courts have looked to apply good faith as a ‘general organizing principle’²⁶⁰ from which duties will flow – the first of which is a duty of honesty. This is a step in the right direction, although a degree of uncertainty remains as to what other duties will emerge from such an approach. Australian state appellate courts have cited good faith as encompassing the three limbs proposed in this dissertation, yet the Australian High Court has not ruled on the matter. I argue in favour of a move toward the Australian approach. While it may require a larger leap initially, it also provides more certainty and ensures a larger degree of coherence in the long term. Co-operation, honesty and reasonableness are all active in New Zealand. As such, a term of good faith encompassing the three would not represent a revolutionary step. Much like Canada, implying a general term of good faith would be a way to clarify a messy area of law in New Zealand. It would allow the individual to more clearly understand their obligations, to make the law more accessible and clear, and to ensure advice provided to parties with regard to their obligations will not be as convoluted (as a result of the existing piece-meal development in this area of the law²⁶¹). Establishing an implied duty of good faith in contractual performance ensures a sensible evolution in the common law. This would bring clarity and consistency with other common law legal systems in an increasingly globalised world.

²⁶⁰ *Bhasin*, above n 1, at [62].

²⁶¹ At what point does a relationship cross the threshold and become what the courts regard as relational and require good faith. Increasing complexity and reliance between the parties would signify such a shift, but the parties are left in the dark and such a determination is up to the discretion of the court.

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