Reasonableness, Honesty and Good Faith

Peter W Jones & Associates, Tauranga, New Zealand

The common law has long recognised that traders may act honestly but still be unreasonable. There has been no general obligation in the common law of the British Commonwealth cast on traders to behave towards each other with good faith in every aspect of their dealings. There are some specific classes of contract which require good faith, and, for instance, insurance contracts require parties to act towards each other with the utmost good faith because of the contracts being based on knowledge solely in the knowledge of the proposer or insured. It is true that over a wide range of duties in contract as well as tort the common law has implied obligations of reasonableness in conduct.

The Australian case of Renard Constructions (ME) Pty Ltd v Minister for Public Works contains an interesting discussion by Priestley JA of the question of the exercise of contractual powers reasonably, compared with their exercise honestly, and compared with the concept of good faith relative to considerations of reasonableness.

The case concerned the interpretation of a construction contract whereby the principal was entitled to take over the works in the event of the contractor's default. The contract provided that as a pre-condition to the principal taking over the work, the principal had to serve notice on the contractor requiring the contractor to show cause why a claimed default would not be sufficient to allow the principal to take over or to cancel the contract. The principal gave notice. The contractor responded. The principal cancelled. There was a dispute. The dispute went to arbitration.

The first arbitrator's award was in favour of the contractor. The principal appealed, leave to appeal having been given. The parties were in agreement at the arbitration that the decision by the principal to cancel the contract had to have been made on a reasonable basis. The arbitrator, on reconsidering the matter after having had it remitted after the first appeal, considered that it was unreasonable of the principal to purport to cancel the contract and that the principal's actions under the circumstances amounted to a repudiation by it of the contract. The arbitrator went on to hold that the contractor was entitled to recover on a quantum meruit.

The appeal from the decision of the arbitrator an the remitted matter was heard by Cole J who held that regardless of what the parties conceded, the cancellation clause did not carry an implied obligation upon the principal to exercise reasonably the power to take over the work and exclude the contractor from the site. The provision did require the principal to give notice on the contractor in answer to a show cause notice 'bona fide, proper and due consideration'. Because the contractor did not submit that there had not been a bona fide exercise by the principal of the powers under the contract, this concession including the principal's consideration of the contractor's response to the show cause notice, it followed that the principal was not in breach of any contractual obligation.

There was consequently an appeal to the New South Wales Court of Appeal, and the leading judgment in the appeal and the cross-appeal was delivered by Priestley JA. The judgment of Priestley JA contains some interesting observations as to questions of construction of contracts and different kinds of implication of terms into contracts: 'In recent years terms implied in contracts have been said to fall into two classes, the first of which has come to be called, somewhat misleadingly, implication in fact, the second, implication by law. The so-called implication in fact is really implication by a judge based on the judge's view of the actual intention of the parties drawn from the surrounding circumstances of the
particular contract, its language, and its purposes, as they emerge from the language and in the circumstances. This has been called implication ad hoc . . .

'It has become accepted that the rules for governing implications ad hoc are those stated by the Privy Council in BP Refinery (Westemport) Pty Ltd v Hastings Shire Council (1977) 52 ALJR 20 and the High Court in Secured Income Real Estate (Australia) Ltd to Salut Martins Investment Pty Ltd (1979) 144 CLR 596 and Codella Construction Pty Ltd v State Rail Authority of New South Wales (1982) 149 CLR 337. Those rules are that the implied term must be reasonable and equitable, necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; so obvious that it 'goes without saying'; capable of clear expression; and must not contradict any expressed term of the contract.

'The other kind of implication 1 have mentioned is that which is said to be implied by law . . . Implication of this kind is difference from implication ad hoc in that the latter occurs in the circumstances of particular individual contracts, whereas implication by law is based an Imputed intention as opposed to actual intention, and implies a term as a legal incident of a particular class of contract'.

His Honour stated that in the present case I think both kinds of implication need to be considered. Having considered types of implication, his Honour decided that a requirement of reasonableness in the application of the show cause clause was required under both heads. His Honour then went on to discuss among other things considerations which confirmed his opinion that reasonableness in performance was implied in the particular clause.

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

'The relevant factors in this area were elucidated by Steyn I in a lecture at Oxford University called "The Role of Good Faith and Fair Dealing in Contract Law" (16 May 1991). Although he recognised in that address (with some regret I think) that the position in England was not the same, in this respect, as in the civil law and in the United States, and although he showed why the difference existed and could continue, he also pointed out a number of reasons why that situation might well change. The chief of these were: (a) that the common law jurisdictions in the United States had in recent times moved decisively towards recognition of the good faith principle; (b) Australian and New Zealand jurisdictions seemed to him to be moving in the same direction; (c) in English law itself it seemed to him that the doctrine of consideration had, in commercial cases, receded in importance; (d) in England also the Law Commission was investigating whether the privity rule should be maintained in its rigid form; (e) remarks made by Bingham LI in the Court of Appeal Division Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989] QB 433 at 445 suggesting a fairness approach to question whether a party should be held to be bound by contractual terms: (f) the ratification by a great many countries of the United Nations Convention an Contracts for the International Sale of goods, art 7(1) of which requires rega4d to be had to the observance of good faith in international trade in the interpretation of the convention; (g) the probable impact of the EEC an English contract law from (as scheduled at the time of his lecture) December 1992; (h) instances where in regard to particular contracts, English Courts had implied good faith obligations; and (i) the passage of statutes such as the Unfair Contact Terms Act 1977 (UK), which empower courts to grant remedies to the affected party to an unreasonable contract. (In regard to this he pointed out the similarity between the concepts involved in the ideas of (i) good faith and fair dealing and (reasonableness).'

His Honour carried an to sketch the history of the obligation of good faith in relation to the performance of contracts in the United States as follows: 'The New York Court of Appeals said in 1918, "Every contract implies good faith and fair dealings between the parties to it": Wigand v Bachmann-Bechtel Brewing Co118 NE 618 (1918) at 619. In his article "Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code" (1963) 30 University of Chicago Law Review 666, Professor Farnsworth made what seems a good case for saying that the court in Wigand was continuing to enforce an obligation long accepted as implied at common law, and which in New York and California was never departed from (see at 671); there are many other examples in the cases. (In England Lord Mansfield had made it plain4 in Carter v Boehm (1766) 3 Burr 1905 at 1910; 97 ER 1162 at 1164, that good faith was a principle "applicable to
all contracts and dealings" and Lord Kenyon in *Mellish v Motteux* (1792) Peake 156 at 157; 170 Er 113-114 had said: "... But in contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith"). Professor Farnsworth recognised that the implied obligation, prior to the promulgation of the Uniform Commercial Code, had become "neglected" in States other than New York and California (at 671).

'The *Uniform Commercial Code* was first promulgated in 1951 by a national Conference of Commissioners of Uniform State Laws and the American Law Institute who hoped it would be made law in each State. It dealt with various aspects of commercial law, but by no means all of it. There were a great many references to "good faith" throughout and I here mention only those particularly relevant for present purposes. Sections 1-203 said "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement". However "good faith" was defined in ss 1-201 as meaning "honesty in fact in the conduct of transaction concerned". This, arguably, had a limiting effect on the extent of the obligation, particularly when in the Sales article (which dealt with "transactions in goods" as described in ss 2-201), "good faith in the case of a merchant" was defined as meaning "honesty in fact and reasonable standards of fair dealing in the trade".

After further discussion of the development of the principle in the United States, His Honour noted the comment of the Ontario Law Reform Commission in its Report an Amendment of the Law of Contract of 1987 that: "... while good faith is not yet an openly recognised contract law doctrine, it is very much a fact in everyday contractual transactions. To the extent that the common law of contracts, as interpreted and developed by our Courts, reflects this reality, it is accurate to state that good faith is a part of our law of contracts.

'In this vein, a great many well-established concepts in contract law reflect a concern for good faith, fair dealing and the protection of reasonable expectations, creating a legal behavioural baseline',

Moving an from His Honour's discussion in Renard, it may be noted that in the Trade Practices Act 1974 in Australia and in the Fair Trading Act 1986 in New Zealand, Australasian legislatures have specifically prohibited persons from engaging in conduct that is misleading or deceptive or is likely to mislead or deceive (Trade Practices Act 1974 Section 52, Fair Trading Act 1986 Section 9).

While the application of the sections is restricted to those who engage in such conduct 'in trade', a widely-adopted statement about Section 52 of the Trade Practices Act 1974 was made by Fox J in *Brown v Jam Factory Pty Ltd*.

'Section 52(1) is a comprehensive provision of wide impact, which does not adopt the language of any common law cause of action. It does not purport to create liability at all, rather does it establish a norm of conduct, failure to observe which has consequences provided for elsewhere in the same statute or under the general law ... In my view effect should be given to the ordinary meaning of the words used. They should not be qualified or (if it be possible) expended by reference to established common law principles or liability. At the same time, known concepts, such as those concerning the torts of deceit or passing off and the analyses made of them over the years, may prove helpful in deciding a case under Section 52(1)'.

It may be argued that there are circumstances where failure to act in good faith could comprise misleading and deceptive conduct in contravention of those statutes. The fact, however, that the legislature in each of Australia and New Zealand has seen fit to record that such behaviour is unlawful, where previously it was not necessarily so at common law (and certainly not in such broad terms), is a further indication of the widening scope of general obligations being imposed by Australian and New Zealand contract and sales law.

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2 Ibid, at pp 255-256.
3 Ibid, at 256.
4 At 263-264.
5 At 265-266.
7 (1981) 3 ATPR 42, 9222 at 42,928.

**Referring Principles:**
I.2.1 - Standard of reasonableness