# THE IMPLIED DUTY OF GOOD FAITH

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The recent decision of the Victorian Court of Appeal in Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL [2005] VSCA 228 is another interesting chapter in cases concerned with the implication of a duty to act in good faith in commercial contracts.

Prior to the decision in Vodafone v Mobile Innovations, the conventional view had become, at least in first instance decisions in NSW, that cases such as Alcatel and Burger King were authority for the proposition that, as a matter of law, parties to a commercial contract were obliged to act in good faith in exercising the rights and powers conferred under the contract.

However, in Vodafone v Mobile Innovations the NSW Court of Appeal concluded that Alcatel and Burger King fell short of treating commercial contracts as a class of contracts carrying the implied good faith term as a legal incident. The court explained that the law had not gone so far and remarked that for the law to do so would involve a 'large step'.

The Vodafone v Mobile Innovations case was a subtle, but relatively clear, retreat from the notion that an obligation to act in good faith ought to be automatically imposed on parties to a commercial contract and apply indiscriminately to all of the rights and powers conferred by the contract.

Arguably, the decision of the Victorian Court of Appeal in Esso v Southern Pacific Petroleum evidences a further retreat by the courts from that notion. The retreat is not evidenced by the outcome of the decision itself, as the court did not decide whether a term requiring the exercise of good faith ought to be implied into the relevant agreement. The court avoided arriving at a concluded view on the matter by deciding that, even if such an obligation were to be hypothetically implied into the contract, it had not been breached.

Rather, the decision in Esso v Southern Pacific Petroleum is of interest because of the 'judicial commentary' contained in the judgments delivered by the court. Chief Justice Warren made some relatively frank observations in relation to the content of the obligation:

> If a duty of good faith exists, it really means that there is a standard of contractual conduct that should be met. The difficulty is that the standard is nebulous. Therefore, the current reticence attending the application and recognition of a duty of good faith probably lies as much with the vagueness and imprecision inherent in defining commercial morality.

Chief Justice Warren did not expressly reject the notion that all commercial contracts carried the implied duty to act in good faith. However, his Honour's dislike for the notion was relatively clear:

> Where commercial leviathans are contractually engaged, it is difficult to see that a duty of good faith will arise, leaving aside duties that might arise in a fiduciary relationship. If one party to a contract is more shrewd, more cunning and out–manoeuvres the other contracting party who did not suffer a disadvantage and who was not vulnerable, it is difficult to see why the latter should have greater protection than that provided by the law of contract.

Buchanan JA also did not flatly reject the notion that all commercial contracts carried an implied duty to act in good faith. His Honour, however, stated that he was 'reluctant' to accept that proposition.

What both Warren CJ and Buchanan JA appear to be suggesting is that there is an additional element when implying a duty to act in good faith into a commercial contract on an ad hoc basis. That element is the vulnerability or substantial disadvantage of one of the parties to the commercial contract.

Rather, both Warren CJ and Buchanan JA envisaged that a duty to act in good faith might be implied into a commercial contract, apparently on an ad hoc basis and only in limited circumstances. Buchanan JA described those limited circumstances in the following terms:

> It may, however, be appropriate in a particular case to import [a duty to act in good faith] to protect a vulnerable party from exploitive conduct which subverts the original purpose for which the contract was made.

Warren CJ described the circumstances in similar terms:

> [T]he interests of certainty in contractual activity should be interfered with only when the relationship between the parties is unbalanced and one party is at a substantial disadvantage, or is particularly vulnerable in the prevailing context.

The tests laid down in BP Refinery for implying a term into a contract on an ad hoc basis are certainly well known. What both Warren CJ and Buchanan JA appear to be suggesting is that there is an additional element when implying a duty to act in good faith into a commercial contract on an ad hoc basis. That element is the vulnerability or substantial disadvantage of one of the parties to the commercial contract.

It may be only a matter of time before the courts will expressly reject the notion that an obligation of good faith is to be automatically implied into all commercial contracts. Further, it will be interesting to see whether the decision in Esso v Southern Pacific Petroleum results in the introduction of a further requirement on a party to establish substantial disadvantage or vulnerability when seeking to imply into a commercial contract a duty to act in good faith on an ad hoc basis.

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