

# GOOD FAITH - IS IT A CONTRACTUAL OBLIGATION?

*Dr. Bruno Zeller\**

## **Observance of Good Faith in International Trade**

### *Introduction*

The principle of good faith in contractual dealings has a varied degree of acceptability. In civil law countries notably in the German and French legal system, good faith is well established. In Australia good faith has a tentative foothold. However England appears to be “the last bastion” clinging to a ‘rigorous interpretation of contractual obligations.’<sup>1</sup> This is not surprising as English law emphasizes an objective approach to contractual issues. Lord Steyn observed that the objective approach made ‘England a somewhat infertile soil for the development of a generalized duty of good faith in the performance of contracts.’<sup>2</sup> Two developments will force this issue to the forefront of debate. First, the impact of the European Community Directives, which in part touch on concepts of good faith, will force the courts and lawyers to confront the meaning of good faith. Secondly the United Kingdom appears to be on the verge of ratifying the Vienna Convention on Contracts for the International Sale of Goods 1980 (CISG), which adopted the principle of good faith.<sup>3</sup> Interestingly good faith is an accepted principle, though mostly latent and inarticulate in the two principal uncoded mixed jurisdictions, namely Scotland and South Africa.<sup>4</sup>

The United States is the only common law country that has included good faith into its statutory regime. Section 1-203 of the *Uniform Commercial Code* states that:

*every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement*

This was reinforced in section 205 of the *Restatement of Contracts, Second* where a duty of good faith and fair dealing was also imposed on the parties in its performance and enforcement.

---

\* Lecturer in Law, Victoria University, Melbourne. I also wish to thank Gerry Box from Victoria University who patiently read and commented on earlier drafts. The usual disclaimers apply.

1 M. Williams, ‘An Introduction to General Principles and Formation of Contracts in the New Chinese Contract Law,’ (2001) 17 *Journal of Contract Law* 13, 17.

2 Lord Steyn, ‘The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?’ 1991, *Denning Law Journal* 131, 132.

3 MacQueen, H.L in Forte, A.D.M (ed) *Good Faith in Contract and Property Law* (1999).

4 *Ibid* 13.

The new Contract Law of the People's Republic of China<sup>5</sup> has also taken note of the principles of good faith and included the principle into several articles. Article 6, the most important one, states: 'The parties shall abide by the principle of honesty and good faith in exercising their rights and performing their obligations.'<sup>6</sup>

Many recent international uniform law documents refer to good faith. The UNIDROIT Principle of International Commercial Contracts as well as the European Principles of Contract Law incorporated articles of good faith in their regime. Our borders have been opened through globalization and it is generally understood that:

*The court system can no longer be regarded as an institution operating exclusively behind national walls. The system now functions increasingly in an international environment and must respond to that circumstance.*<sup>7</sup>

Any debate on principles such as good faith should recognise that legal systems influence each other. The spread of ideas from one legal system to another has opened domestic law to external influences.<sup>8</sup> Farnsworth, in a speech in Italy, referred to Justice Steyn who in a lecture at Oxford in 1991 gave two reasons why English law might in future be more receptive to good faith. The two reasons are first the acceptance of good faith as a doctrine in a common law jurisdiction namely the United States and secondly the 'ratification by many countries of the Vienna sales convention, which contains a provision of good faith.'<sup>9</sup>

With increased regularity international law influences domestic law. As an example the New Zealand Court of Appeal commented that:

*Much more significant are the facts that the Court is faced with interpreting [international] legislation – and not, directly at least, with applying the common law ... [and] it would be singularly inappropriate to import into the construction ... technical rules of the common law.*<sup>10</sup>

However the current High Court and specifically Justice Kirby did not take any external principles into consideration when he addressed 'the growing tendency to

---

5 Promulgated in the Second Session of the Ninth National People's Congress on March 15, 1999.

6 New Chinese Contract Law, above n 299.

7 M. Gleeson, 'The State of the Judicature', (1999) *The Law Institute Journal*, 74.

8 A. Farnsworth, 'The Concept of 'Good Faith' in American Law,' *Saggi Conference e Seminari Paper 10*, Centro di studi e ricerche di diritto comparato e straniero.

9 *Ibid.*

10 *Integrity Cars (Wholesale) Ltd v Chief Executive of New Zealand & Anor* [2001] NZCA 113, 19.

imply into private contractual dealings a covenant of good faith and fair dealing.<sup>11</sup> In what could be termed a rebuff to current trends, Justice Kirby noted that:

*In Australia such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent in common law conceptions of economic freedom. It also appears inconsistent with the law as it has developed in this country in respect of the introduction of implied terms.*<sup>12</sup>

It has been argued that ‘the time is ripe for the courts to critically examine whether or not the concept of good faith should be imposed into contracts that are freely entered into by commercial parties.’<sup>13</sup> This paper argues that the time has come for courts to examine the principle of good faith by directing their attention beyond national boundaries in order to come to an understanding of what good faith means.

#### *CISG article 7(1) and Domestic Law*

Much has been written on good faith. Few however acknowledged that good faith is already an established principle in Australian domestic law. With the ratification of the CISG, Australian domestic law has in effect already imported the principle of good faith into its regime. The CISG in article 7(1) requires that good faith must be observed in international trade.<sup>14</sup> There is no debate that courts cannot construe an international sale by reference to pre-existing notions derived from domestic law.<sup>15</sup> What is argued is that the principle of good faith as contained in article 7(1) can be extended to the interpretation of domestic contracts including implied terms. Good faith is a well-established principle not only in civil law jurisdictions but also in common law countries such as the United States and to a lesser degree Canada. If good faith is to be established a construction based on an international understanding must be viewed as being preferred as it defeats ethnocentric views that are potentially not in step with international developments.

The significance of such an observation is that Australian domestic contract law must recognise the principle of good faith, otherwise a system can develop where

---

11 *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5 (14 February 2002), 86.

12 *Ibid* 87.

13 Baron, A. “Good Faith and construction contracts – From small acorns large oaks grow.” (2002) 22 *Australian Bar Review*. 1, 28.

14 Article 7(1) states in full:

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

15 An excellent example of how international treaties should be applied can be found in *Povey v Civil Aviation Safety Authority and Ors* [2002] VSC 580

foreign litigants are treated differently from their domestic counterparts. To date unfortunately, only two judges namely Priestley J in *Renard Constructions v Minister for Public Works*<sup>16</sup> and Finn J in *South Sydney District Rugby League Football Club v News Ltd (South Sydney)*<sup>17</sup> have referred to article 7(1) of the CISG. More significantly most articles referring to *Renard* such as Baron<sup>18</sup> and Carlin<sup>19</sup> when “deciphering *Renard*”<sup>20</sup> do not allude to this fact. “Deciphering *Renard*” arguably can be narrowed to two simple observations. First, Priestley JA urged that the principle of good faith ought to be considered and, secondly, he alluded to the fact that the CISG ought to be taken into consideration when doing so.

Peden seems to be one of the few authors who recognized the importance of the CISG. She noted that the comments by Finn J in relation to the CISG in *South Sydney* ‘suggest that a different approach would be more realistic and certain.’<sup>21</sup> Baron<sup>22</sup> on the other hand only noted that Finn J. said that Australia had not yet ‘committed itself unqualifiedly to the proposition that every contract imposes on each party a duty of good faith ... in contract performance and enforcement.’<sup>23</sup> However Finn J continued that particular passage where he said that despite the fact that there is supposed uncertainty with good faith terminology, the States and Territories were not deterred from introducing article 7(1) of the CISG into domestic law.<sup>24</sup> The full passage shows the true intent of Finn J.

This paper therefore will address two important questions. First, how is good faith determined under the CISG and how can such knowledge shape the perception of good faith in existing Australian jurisprudence? This is of great importance specially considering views stating that:

*Given the tortured development of the doctrine of good faith in contractual performance in Australia, the hallmark of which seems to have been misconstruction heaped upon misconstruction ...*<sup>25</sup>

---

16 (1992), 26 NSWLR, 234

17 [2000] FCA 1541 (November 3, 2000).

18 Baron, A. above n 13.

19 Carlin, T.M., “The Rise and Fall? of Implied Duties of Good Faith in Contractual Performance in Australia” (2002) 1 The University of New South Wales Law Journal, 99.

20 Ibid 104.

21 Peden, E. ‘Incorporating Terms of Good Faith in Contract Law in Australia’, 23 Sydney Law Review, 222, 237.

22 Baron above n 17, 17.

23 South Sydney above n 17, 393.

24 Ibid.

25 Carlin above n 18, 122.

Secondly how can good faith be applied in a contract? The answer to the second question appears simple. Good faith can be applied only if it is either an express or implied clause in a contract. But it will be argued that good faith goes beyond the restrictive regime of terms of contract as good faith also contains a directive to the judiciary to interpret legislation and contracts in good faith. As good faith is a term such knowledge is of importance as it maps the territory into which good faith is to be introduced. It will also give an opportunity to understand practices which are conducive or alternatively, which need to be modified or abandoned before a successful introduction of good faith can eventuate and it becomes a recognized principle in domestic law.

Specifically it will be argued that principles founded on classic contract theory must accordingly be modified or abandoned. The reality in a globalised business world is that contracts are a narrative of economic experiences and relationships. A contract does not contain the complete bargain in detail but relies on principles of good faith in its execution and reconstruction in case of a dispute.

### **Good Faith a Principle under the CISG**

#### *Introduction*

It is universally recognized that the meaning of good faith poses a problem, as a definitive and precise meaning of the term is elusive. Even in Germany where good faith has been recognized for over one hundred years, and an extensive library of relevant cases exists, no actual definition of good faith has been established.<sup>26</sup> The drafters of the CISG also feared that a precise definition and application might not be possible.<sup>27</sup> However, despite such misgivings the CISG appears to have managed the inclusion of good faith without too much controversy. Arguably a definition of good faith is not needed in order to understand and apply such a concept if we reflect that:

*[a] study not of contract law, but rather of contract practice is the key to understanding the economic properties of contracting that are necessary to work out sensible uniform laws for commercial purposes.<sup>28</sup>*

The suggestion here is that an initial understanding of good faith is derived from a study of what judges, jurists and legislators have referred to as being examples of good faith. The core principles of good faith can then be extracted from this stock

---

26 P.J Powers,. 'Defining the Undefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods' (1999) 18 Journal of Law and Commerce 333, 334.

27 Ibid 337.

28 R. Amissah, 'The Autonomous Contract, reflecting the borderless electronic-commercial environment in contracting' (1997) Electronic Handel – rettslige aspekter – Oslo [<http://www.cisg.law.pace.edu/cisg/biblio/amissah2.html>], 10, 13.

of knowledge.<sup>29</sup> It is through the uniform international laws as expressed by conventions that a meaning or definition of good faith can be gained. Also a significant body of law is available which our courts may use and apply in the interpretation of good faith. Ultimately a meaningful study of contract practices will only be achieved in Australia if our attention is focused on domestic as well as international law

*Good Faith and the CISG*

This paper takes the view that good faith has a dual role. First it must be used in interpreting the Convention. Secondly it regulates the behavior of the contractual parties.

Good faith therefore has two distinct functions or roles. First good faith is examined as a state of mind and secondly it is looked at as a principle found in various articles. It has been suggested that a definition of good faith is necessary for an understanding of article 7(1). However it is argued that such a definition does not help to advance the application of good faith. Attempts have been made to define good faith. As an example Powers suggests that:

*The duty of good faith can be defined as an expectation and obligation to act honestly and fairly in the performance of one's contractual duties. A certain amount of reasonableness is expected from the contracting parties.*<sup>30</sup>

This may be true but how is such a definition to be applied? It still leaves the judiciary with a 'functional problem'. Powers included only one function in his definition, namely the application of good faith to contractual obligations. He has not included in his definition a treatment of good faith as applicable to the Convention as a whole. How can good faith, as applied to the Convention, impose a requirement to act 'honestly and fairly' if the outcome is not directly applicable? More to the point, good faith is a precondition, a holistic mind-set, which can be applied through concrete examples to the behavior of parties. It is more useful to look at approaches rather than definitions to explain the function of good faith. This is especially so as in many cases courts do not rely expressly on good faith. It arises often only through the interpretation of results. Not surprisingly, good faith can mean different things depending on the context of the contract and to that end, courts are 'merely required to ensure that the parties have genuinely adhered to the bargain which they entered into.'<sup>31</sup>

---

29 Blackie, J.W.G, 'Good Faith and the Doctrine of Personal Bar' in Forte, A.D.M (ed) *Good Faith in Contract and Property Law* (1999), 130.

30 P. J. Powers, above n 26, 335.

31 Peden, E. above n 20, 238.

*A Principle Expressed as a State of Mind*

Good faith covers the application of the Convention as well as the rights and obligations of the parties. In simple terms it is a 'general duty' based on judicial interpretation of community standards, reasonableness and fair play.<sup>32</sup> Good faith as indicated is a general duty and not a duty based on morality. This approach has already been taken in the drafting process of article 7(1).<sup>33</sup> It would be presumptuous to suggest that article 7(1) is based on morality. Such a concept would never lead to uniformity of application, as morality is a social duty based on cultural norms. In international law good faith must be a concept capable of treading a middle ground that is acceptable to all. For that reason its definition must be a general practical duty rather than a specific one. Simply put, good faith requires the parties to cooperate 'in carrying out the interlocking steps of an international sales transaction'.<sup>34</sup>

To this point only the application of good faith has been discussed but not what good faith actually means within the context of the CISG. A brief examination of domestic laws and its treatment of good faith shows two things. First there is no universally accepted definition of good faith. Secondly each country treats the principle of good faith differently. It is argued that good faith is not only a concept but also a state of mind. Peden in essence reaches the same conclusion namely that a state of mind is essential in the application of good faith. She argues that good faith should be a tool of construction whereby:

*... [Courts are] to construe all contracts on the basis that there is expectancy of good faith in all terms, unless there is something explicit to suggest otherwise.*<sup>35</sup>

Arguably if courts do not mention or refer to good faith it should be understood that good faith was present and was evident in all terms of the contract. It is only if bad faith is present or good faith is explicitly excluded is there a need for a court to comment on the principle of good faith. Failure of a court to address the issue of good faith thus implies that good faith was exercised.

As far as the CISG is concerned the appropriate starting point is to go back to article 4, which states that the CISG only 'governs the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a

---

32 D. Stack, 'The Two Standards of Good Faith in Canadian Contract Law' (1999) 62 Saskatchewan Law Review 210, 201.

33 J. Honnold, *Documentary History of the Uniform Law for International Sale* (1989), 369.

34 A. Kritzer, *Guide to Practical Application of the United Nations Convention on Contracts for the International Sale of Goods* (1989) 115. [<http://cisgw3.law.pace.edu.html>]

35 Peden, E. above n 20, 230.

contract'. Article 7(1) recognizes that good faith is applied in the interpretation of the totality of the CISG. The mandate is primarily directed to the judiciary to interpret the CISG in good faith. Such an interpretation covers the formation of the contract and the rights and obligations of the buyer and seller. Article 7 also creates a principle that good faith be found throughout the CISG such as in article 40. As such it is not only directed to the judiciary but also to the parties as noted by the Court d'Appel de Grenoble in *SARL Bri Production "Bonaventure" v. Societe Pan African Export (Bonaventure)*.<sup>36</sup> The language of article 4 also supports such a conclusion. The question is whether good faith extends beyond the specific instructions that are to be found within the Convention? In other words, is the mandate in article 7 broad enough to allow the judiciary as well as the parties to the contract to rely on a general principle of good faith and to apply it to any conduct not consistent with good faith?

There is no controversy in stating that article 7(1) urges the judiciary and the parties to the contract to observe good faith in international trade. The purpose of article 7(1) is to ensure that the Convention is interpreted in good faith. It therefore refers to the state of mind of those interpreting the Convention. The natural or normal state of mind when interpreting the Convention is with good faith. Article 8<sup>37</sup> of the CISG assists in this regard by prescribing that the subjective as well as objective standard is to be taken into consideration.

It can be argued that there is no need to refer in the jurisprudence to article 7(1) as this article is applied to every case at hand in the 'normal course' of interpreting the CISG. In a German case the court looked at the relationship between articles 49 and 48. Article 49, which covers the buyer's right to avoid the contract prevails over the seller's right to cure defects, which are covered in article 48. The court noted, by referring to the underlying purpose of the provision (*Sinn und Zweck der Vorschrift*) that article 49 only prevails if the delivery of non-conforming goods amounts to a fundamental breach.<sup>38</sup> Significantly the court's

---

36 Court d'Appel Grenoble, February 22, 1995  
[<http://cisgw3.law.pace.edu/cases/950222f1.html>]

37 Article 8 states:

For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what the intent was.

If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances. In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

38 Oberlandesgericht Koblenz, January 31, 1997,  
[<http://cisgw3.law.pace.edu/cases/970131g1.html>]



view was that - even if the defects were serious - it does not amount to a fundamental breach if the seller is willing to deliver substitute goods without unduly inconveniencing the buyer.<sup>39</sup> This choice of words indicates that the court took note of the mandate of good faith. The state of mind of the court was such that it automatically applied good faith. Good faith was used as a tool of construction or a principle. In such a manner courts can apply good faith to all contracts irrespective of policy considerations.<sup>40</sup> A commercial interpretation through the 'implied in law' approach is flawed as any importation of good faith depends on the type of contract because different policy considerations make it impossible to imply terms into every contract.<sup>41</sup>

The Bundesgerichtshof of Germany had to decide whether the seller waived his right to rely on articles 38 and 39. The CISG deals with such a waiver under article 40. The court noted that the seller implicitly waived his right.<sup>42</sup> The seller entered into protracted negotiations over the lack of conformity and even offered compensation and paid for an expert at the buyer's request, which showed that the seller by implication waived his rights to rely on article 39.<sup>43</sup> Such an argument is based on a recognition that the CISG must be interpreted with good faith and also that the parties to a contract can rely on good faith behavior. Good faith is shown, as the courts did not rely on the technical constructions of article 38 and 39. Again article 7(1) was not expressly quoted, which suggests that good faith is nevertheless applied but as a state of mind. Good faith in this context does not require a definition and arguably a doctrine of good faith is not required.

The conclusion therefore is that article 7(1) needs to be specifically invoked only when specific or unusual circumstances compel the judiciary to note the absence of good faith.

But this does not determine whether the CISG has to be interpreted with good faith in mind. It is possible that good faith is not applied at all. An outcome could also be the result of ignorance or mistake of some kind. The logical contention is that the interpretation of the CISG in good faith would minimize errors. However, in the end we are still dealing with a state of mind and therefore measurable outcomes cannot be identified. The application of good faith after all demands a 'holistic approach'. Such a view may be strengthened by an analogical extension of history. Historians believe that information in letters and chronicles mainly describe items that are newsworthy. People seldom report facts that are either known by the other party or are universally known. It can therefore be argued that all those interpreting the CISG will do so exercising good faith in the process.

---

39 Ibid.

40 Peden, E. above n 20, 230.

41 Ibid.

42 November 25, 1998, [<http://cisgw3.law.pace.edu/cases/981125g1.html>]

43 Ibid.

Only if the presence of good faith is disturbed is there a need to comment and apply explicitly article 7(1). Arguably the only time good faith is present is when bad faith is apparent. The Colombian Constitutional Court noted:

*There is nothing more against reality: in all juridical systems that recognize the principle of good faith, validation is a form of granting security to the life of business and, in general, to all judicial relationships.*<sup>44</sup>

No direct penalties or remedies flow from a breach of the principle of good faith, as it applies to the Convention as a whole. The same applies to the parties. If a party fails to act in good faith and is not in direct breach of any other articles within the Convention, the CISG through article 7(1) does not allow the court 'to manufacture' remedies or principles as shown in *Bonaventure*.<sup>45</sup> The court awarded 10,000 francs damages that were punitive and had no connection with a breach of good faith. The Australian Trade Practices Act in s52 also applies a similar mandate in stating that a corporation shall not engage in conduct that is misleading or deceptive. Fox J states that [s.52] 'does not purport to create liability at all; rather it establishes a norm of conduct'.<sup>46</sup> However, unlike the CISG the Trade Practices Act introduces consequences for failure to observe s.52 'elsewhere in the same statute, or under general law'.<sup>47</sup> As the CISG does not provide for failure to observe article 7 and hence creates a gap, the courts are free to apply domestic law as shown again in *Bonaventure* where the court applied French domestic law to compensate the plaintiff for abuse of process.

#### *As a Principle in Prescribed Situations*

The reverse is true if good faith or bad faith is exhibited in direct conflict with articles where the principle of good faith is included such as article 40. In these circumstances a breach of these articles requires the court to invoke the principle of good faith but the court is not required to embark on a great 'philosophical dissertation' to discover the meaning of good faith. Good faith is linked directly to prescribed situations and hence is explained. There are several articles, which require the use of good faith as a principle but only one will be discussed to illustrate the above point.

#### *Article 40*

---

44 Columbia May 19, 2000, Sentencia C-529/00; referencia: expediente LAT-154, [<http://cisgw3.law.pace.edu/cases/000510c7.html>] translated by Queen Mary Case Translation Program.

45 See above n 36.

46 *Brown v Jam Factory Pty Ltd*, above n 313.

47 *Ibid*.

*Beijing Light Automobile Co., Ltd v. Connell Limited Partnership (Beijing Metals)*<sup>48</sup> has to be regarded as the leading case on the question whether article 40 is applicable. A lock plate installed in a machine broke four years after installation. Pursuant to article 39(2) the buyer loses the right to rely on a lack of conformity of goods after two years. Article 40 states that; ‘The seller is not entitled to rely on the provisions of article 38 and 39 if the lack of conformity relates to facts which he knew or could not have been unaware of and which he did not disclose to the buyer’.<sup>49</sup> The seller, in other words, has an obligation to disclose defects. This article is the ‘safety valve’ which allows a buyer to overcome articles 38 and 39 if the reason for his late discovery of non-conformity is based on the seller exhibiting bad faith (or not exhibiting good faith). The first comment the court made is that article 40 is only to be applied in special circumstances. The court must be convinced that a fact of which the seller had knowledge or ought to have had in its mind resulted in a loss to the buyer. Such conduct can be described as an awareness of bad faith.<sup>50</sup>

*The requisite state of awareness that is the threshold criterion for the application of article 40 must in the Tribunal’s opinion amount to at least a conscious disregard of facts that meet the eyes and are of evident relevance to the non-conformity.*<sup>51</sup>

Such a ruling is consistent with the views of the Oberlandesgericht München, which noted that bad faith is shown if the seller ignores faults which are obvious to the eye and which are discoverable by simple care and attention of the seller.<sup>52</sup> Some scholars argue that the standard for reliance on article 40 must be at least due to ‘slightly more than gross negligence’ or even ‘approaching deliberate negligence’.<sup>53</sup> This suggests that article 40 should only be applied in exceptional circumstances and not in special circumstances.<sup>54</sup> However, the real consideration behind any standard must be the principle of good faith. Good faith requires, as the arbitration tribunal noted, a ‘requisite state of mind’.<sup>55</sup> It can be argued that a

---

48 Stockholm Chamber of Commerce Arbitration Award of June 5, 1998 [<http://cisgw3.law.pace.edu/cases/980605s5.html>]

49 F. Enderlein and D.Maskow, "International Sales Law, United Nations Convention on Contracts for the International Sale of Goods" (1992), 163.

50 Bad faith as opposed to good faith is not to be confused with dishonesty, which the law never condoned. The courts - as cited above - interpret the lack of good faith as a reckless indifference by the seller which does not amount to dishonesty.

51 See above n 48.

52 Oberlandesgericht München, 7. Zivilsenat, March 11, 1998, 7 U 4427/97, [<http://www.jura.uni-freiburg.de/ipr1/cisg/urteile/text/310.html>].

53 F. Limbach and B. Ahearn, Case commentary “Arbitration Institute of the Stockholm Chamber of Commerce Arbitration Award, June 5th, 1998” [<http://cisgw.law.pace.edu/cisg/biblio/limbach.html>] last update January 27,2000.

54 Ibid.

55 Ibid.

breach of good faith has started once the seller ought to have discovered the non-conformity. In other words once non-conformity is shown to be evident to the eye as pointed out by the Stockholm Chamber of Commerce, a breach of good faith has occurred.

In relation to good faith, the courts have not resolved an issue of a conceptual nature but rather put a practical interpretation on a conceptual issue. In another case, the Landgericht Stuttgart criticized the lower court as it allowed article 40 to be used despite the fact that the seller tried to use the article to overcome his breach of the contract.<sup>56</sup> This is an indication that the principle of good faith was applied correctly in the spirit and manner contemplated by those who drafted article 7(1). The same observation also applies to other articles, which include an observance of good faith.

### *The Jurisprudence of Good Faith*

The presence of good faith as an obligation of the parties in the jurisprudence of the CISG is impressive. In *Filanto S.p.A. v. Chilewich International Corp. (Filanto)*<sup>57</sup> the court by implication applied the principle of good faith. Specifically the court noted that *Filanto* 'cannot rely on the contract when it works to their advantage and repudiate it when it works to their disadvantage'.<sup>58</sup> The key ruling of the court 'may . . . be read as saying that parties in a long-term relationship owe to each other a duty to communicate, a duty which ultimately may be derived from a duty to act in good faith'.<sup>59</sup>

In *Dulces Luisi, S.A. de C.V. v. Seoul International Co. Ltd y Seolia Confectionery Co*<sup>60</sup> article 7 was used to impose a standard of behavior upon the parties. The behavior of the Korean buyer was contrary to the principle of good faith. A Budapest arbitration proceeding applied article 7(1) as a standard to be observed by the parties.<sup>61</sup> The arbitrator noted that the issuance of a bank guarantee, which had already expired, was contrary to the principle of good faith.<sup>62</sup> In *Bonaventure*<sup>63</sup> the seller was insistent to know where the goods namely jeans were sent. It was specified that the jeans were to be sold to South America and Africa.

---

56 August 13, 1991, 16 S 40/91 [<http://cisgw3.law.pace.edu/cases/910813g.1.html>] last update May 14, 2001.

57 United States, April 14, 1992 U.S. Dist.Ct. [<http://cisgw3.law.pace.edu/cases/920414u1.html>].

58 Ibid.

59 Winship, Peter 'The UN Sales Convention and the Emerging Case Law', in *Emptio-Venditio Internationales*, Neumayer ed. (1997) 228.

60 Mexico November 30, 1998 [<http://cisgw3.law.pace.edu/cases/981130m.1.html>].

61 Budapest arbitration proceeding Vb 94124 November 17, 1995 [<http://cisgw3.law.pace.edu/cases/951117h1.html>]

62 Ibid.

63 See above n 36.

The purchaser however despite assurances to the contrary sent the jeans to Spain. The plaintiff claimed 10,000 francs as compensation for abuse of process. The court agreed with the plaintiff's position and found that the buyer acted contrary to the principles of good faith in international trade pursuant to article 7(1).

More conventionally, good faith performs a dual role: one directed to the parties, the other to the judiciary. 'The former role arises from the textual provisions and the general principles of the Convention, and the latter role comes from the legislative history of the Convention.'<sup>64</sup> The views of Professor Ziegel are relevant. He stated that article 7(1) 'does not refer specifically to the observance of good faith in the formation of the contract, its language is sufficiently broad to admit its inclusion'.<sup>65</sup>

Article 7(1) explains how the CISG must be applied. Textual interpretation of an article leads to the discovery that its primary role is to interpret the Convention. Thus it allows the interpreter to discover that such an obligation creates a principle of "good faith". As there is an obligation to read and interpret the articles within the context of the CISG, such a principle must be applied to the relationship of the parties. Subsequent articles regulate such a relationship.

In *Diepeveen-Dirkson BV v. Nieuwenhoven Veehandel GmbH*<sup>66</sup> the seller signed a contract, which contained a penalty clause. The seller contended that the penalty was disproportionate to the harm suffered by the buyer. The seller argued that on grounds of good faith and fairness the penalty ought to be decreased to a more appropriate level. The court found that the principle of good faith does not extend to terms willingly entered into by parties and found no basis within the CISG to reduce the penalty. After all, the question as to penalty clauses is governed under domestic law.

The principle of good faith still needs to be further developed. Professor Farnsworth showed a great deal of insight when he noted at the advent of the UCC:

*Still the lesson is there, and the Code's concepts of good faith performance and commercial reasonableness await development, even beyond the bounds of the Code, at the hands of resourceful lawyers and creative judges.*<sup>67</sup>

---

64 Ibid.

65 J.S Ziegel, 'Report to the Uniform Law Conference of Canada on Convention on contracts for the International Sale of Goods' [<http://www.cisg.law.pace.edu/cisg/text/ziegel7.html>] last update April 23, 1999.

66 Netherlands August 22, 1995 [<http://cisgw3.law.pace.edu/cases/950822n1.html>]

67 A.E. Farnsworth, 'Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code' (1963) 30 U. Chicago Law Revue 666, 679.

### *Conclusion*

The CISG itself does not offer much help in defining good faith. In German domestic jurisprudence the same is applicable and one must read between the lines to find a definition.<sup>68</sup> Both PICC and PECL have introduced a definition or closer description of good faith into their model laws. Arguably a debate as to the standard of good faith is not needed in relation to the CISG. Conceivably the drafters of the CISG by design or good luck have avoided the need for courts to 'adopt a doctrine of good faith ... to improve contract enforcement'<sup>69</sup> by tying good faith to specific situations. However the fact remains that good faith is a recognised principle within the CISG. More importantly the vehicle by which the principle can be implemented is also contained within the convention namely in article 8. Article 8 in brief allows the judiciary to inquire not only into the objective but also into the subjective intent of parties. In other words an inquiry into the expectations of a contractual arrangement is possible. In essence under the CISG the answer to the following question runs contrary to the common law.

*Why generally impose an obligation which might be antithetical to the nature of the relationship between parties, and which, were it important to those parties, could have been expressly bargained for?<sup>70</sup>*

It is argued that a contract is not the sum total of a relationship but rather the narrative of economic experiences and relationships. As such the contractual document does not spell out what parties have expressly bargained for. The totality of a relationship exists in the intent of parties, which is subjectively, as well as objectively exhibited and must be examined as such by courts and tribunals. Arguably it is not the principle of good faith, that is the problem, but rather the vehicle by which good faith is imported into contracts that may be faulty or unsuitable. Accordingly an examination of how a term of good faith can be imported into a contract is warranted.

### **Good faith as a Term**

#### *Introduction*

An obligation to act in good faith may be assumed by the parties either expressly or by implication. The courts and tribunals should be able to give effect to such a term, provided the legal system recognizes it as a valid legal obligation. The fact that parties express obligations of good faith in their dealings has long been accepted. However the problem lies with courts who do not know what the term good faith actually means. There are still calls to the effect that 'Australian

---

68 Powers, above n 26, 337.

69 Stack, above n 32, 223.

70 Carlin, above n 18, 109.

jurisprudence would be better served by a return to the accepted wisdom of pre-*Renard* days'.<sup>71</sup> Such a call is astonishing considering that good faith is a recognized principle in most international documents which Australian courts undoubtedly need to interpret at one stage or another. More of a concern is that Carlin in his discussion of the judgment in *Hughes Aircraft Systems International v. Airservices Australia*<sup>72</sup> noted:

*... the discussion of good faith revolved around two key themes: a neo-internationalist rationale for the adoption of a doctrine of good faith ...*<sup>73</sup>

He added to the above remark a quotation from Sir Anthony Mason warning that American case law is a trackless jungle ...<sup>74</sup> There is no debate that Sir Anthony Mason was correct with his remark and indeed it would be inappropriate to follow foreign domestic law. However of significance (and omitted by Carlin) is that Finn J. noted:

It (good faith) has been propounded as a fundamental principle to be honored in international commercial contracts: see eg UNIDROIT.<sup>75</sup>

There is indeed a difference between American case law and fundamental principles set out in UNIDROIT or the CISG for that matter. Both these principles are uniform international laws and the CISG has been incorporated in our domestic law anyway. Therefore Finn J merely proposed the obvious and certainly did not follow a “neo-internationalist rationale.” The debate can be summed with Finn J observing that:

*Its [good faith] more open recognition in our own contract law is now warranted notwithstanding the significant adjustments this would occasion to some of contract law's apparent orthodoxies.*<sup>76</sup>

Is it better to remain in splendid and secure isolation or take a chance and move with the times and experience a time of uncertainty?

The answer arguably is clear. Unless the common law courts accept the obligation to give effect to the wishes of contractual parties the principle of good faith will divide contract practices of the common law and civil law countries. Furthermore as many international conventions such as the CISG included good faith in their regime domestic courts will sooner or later come into contact with the principle of

---

71 Ibid 101.

72 [1997] 146 ALR 1.

73 Carlin above n 18, 116.

74 Ibid.

75 Hughes Aircraft above n 72, 37.

76 Ibid.

good faith. The CISG has an advantage as the drafters have recognized good faith as being a general principle. Hence there is an obligation on the judiciary and the parties to interpret not only the CISG but also the contractual dealings in good faith. It would be interesting to speculate whether a breach of article 7(1) specifically a courts unwillingness or inability to interpret the contract or the convention in good faith would be grounds for an appeal on a point of law.

*Good Faith as an Express Term*

Good faith can undoubtedly be an express term in a contract expressing a party's intention. Alternatively good faith can arguably be a part of a legislative mandate requiring its inclusion into a contract. It may be understandable if courts refuse to give effect to an implied term but a refusal to give effect to an express term would be unexpected. However this is what English law does according to the decision of the House of Lords in *Walford v Miles*.<sup>77</sup> The question was one of the validity of a lock-in agreement. The House of Lords did not recognize the existence of an obligation to negotiate in good faith for reasons of certainty and of policy.<sup>78</sup> Lord Ackner stated the policy reasons.

*The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties involved in negotiations. ... A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party.*<sup>79</sup>

It appears that the principle to negotiate in good faith was rejected for several reasons. The most important reason was that the House of Lords was willing to give effect to an obligation to use 'best endeavours'<sup>80</sup> which in their minds must have been at least something different from an obligation to "negotiate in good faith". It is curious to note that "best or reasonable endeavours" should not be contrary to the above policy reasons without at least attempting to distinguish between the terms of good faith and best endeavours. Arguably Lord Ackner would have reached a different position had one of the parties negotiated in bad faith and intentionally endeavoured not to reach an agreement.

The reason could well be that the House of Lords was not so much "put off" by the term of good faith but rather viewed a duty to negotiate as a dangerous policy. It certainly does not require a leap of faith to argue that best endeavours and good faith are not so far apart that good faith must be rejected out of hand. Furthermore the best endeavours clause is not always valid as it is uncertain and

---

77 [1992] 2 AC 128.

78 E McKendrick in A D M Forte (ed) above n 3, 49.

79 *Walford v Miles* above n 77, 138.

80 Ibid.



enforceable.<sup>81</sup> Also to make reasonable endeavours is inherently more difficult to argue than to negotiate in good faith.

*Ordinarily an agreement to negotiate in good faith would simply exclude bad faith conduct whereas a reasonable endeavours undertaking raises questions about what is to be agreed as well as the relevance of the considerations which might influence a party in refusing to agree.*<sup>82</sup>

Implied in Lord Ackner's view is that the court took away the parties' freedom of contract as they abandoned the adversarial stance.<sup>83</sup> It is surprising to see that the House of Lords, by implication, indicated that the uncertainty argument should have taken precedence over the argument of freedom of contract. This is specifically the case as the whole speech of Lord Ackner is based on the assumption that negotiating parties actually take on an adversarial stance in their negotiations.

In Australia *Walford v Miles* has been accorded persuasive status. The problem however is that no clear indication of what Lord Ackner intended to say has been expressed. Powell JA suggested that:

*Although I share the view expressed by Handley JA ... that a promise to negotiate in good faith is illusory and therefore cannot be binding [Walford v. Miles] I must recognise the fact that, at least in this State a possibility that a promise to negotiate in good faith may, in particular circumstances, be enforceable has been recognized.*<sup>84</sup>

Einfeld J. referring to *Walford v Miles* contended that, 'the law does not recognise as an enforceable contract an agreement to agree or negotiate a contract'.<sup>85</sup> Giles JA on the other hand argued that:

*Whether the law recognises an agreement to negotiate in good faith can not be regarded as settled. Kirby P and Waddell AJA were prepared to countenance such an agreement but Handley JA was not. The reasoning of Handley JA found support in the later decision of the House of Lords Walford v Miles.*<sup>86</sup>

---

81 *Little v Courage Ltd* (1994) 70 P & C.R. 469, 476.

82 A F Mason, 'Good Faith and Equitable Standards', (2000) 116 L.Q.R. 66, 80.

83 McKendrick above n 3, 50.

84 *Kurnell Developments Pty. Limited & Anor. v. Orica Australia Pty. Limited & Ors.* [1999] NSWCA 163 (11 June 1999), 72.

85 *Svi Systems Pty Limited v Best & Less Pty Limited* [2001] FCA 279 (20 March 2001), 75.

86 *Healey v Commonwealth Bank of Australia* Matter No CA 40219/98 [1998] NSWSC 678 (8 December 1998), at 5.

It appears that the decision in *Walford v Miles* has not been understood and applied uniformly. The distinction between “to negotiate in good faith” or to “negotiate a contract” has not been clearly spelled out. It is unfortunate that Lord Acker did not separate the legal issue to negotiate and the good faith issue. Arguably both issues are different and exist in their own right.

*Good Faith as an Implied Term*

The second group and the more interesting one is if the term good faith is implied by courts. Good faith is only one of the possible implied terms, which courts can incorporate into contracts. Consequently a study of contract practices is warranted to understand the climate in which implied terms, such as good faith, can be applied by courts.

It has been argued that there seems to be an increasing tendency in Australia for courts to incorporate obligations of good faith into contracts.<sup>87</sup> This may be so, but equally well Mason J’s observation in *Codelfa Construction Pty Ltd v State Rail Authority*<sup>88</sup> still holds true :

*For obvious reasons the courts are slow to imply a term. In many cases, what the parties have actually agreed upon represents the totality of their willingness to agree.*<sup>89</sup>

Kirby J expressed the same caution in a recent judgment where he noted:

*Whatever may be the precise legal criterion for implying terms into a contract upon which the parties have not expressly agreed, it would always be necessary for a court of our legal tradition to be very cautious about the imposition on the parties of a term that, for themselves, they had failed, omitted or refused to agree upon. Such caution is inherent in the economic freedom to which the law of contract gives effect. Absent some statutory or equitable basis for intervention, it is ordinarily left to parties themselves to formulate any agreement to which they consent to be bound in law.*<sup>90</sup>

Arguably Kirby J was too cautious in formulating a situation in which terms can be implied into contracts. To give business efficacy to contracts appears to be the most common justification to imply terms into contracts.

---

87 E Peden, above n 20, 224.

88 (1982) 149 CLR 337.

89 Ibid 346.

90 *Roxborough v Rothmans of Pall Mall Australia Pty Ltd* [2001] HCA 68 (6 December 2001)

However a broader question must be asked namely under what circumstances can terms in general be implied into contracts especially if it is considered that the common law still appears to follow the objective theory of agreement as expressed in *Smith v Hughes*.<sup>91</sup> The common law test for implying a term to repair an intrinsic absence of expression is enunciated in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*<sup>92</sup> which represents current New South Wales law.<sup>93</sup> For a term to be implied the following conditions must be satisfied:

*“(1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that ‘it goes without saying’; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.”*<sup>94</sup>

Examining the five conditions it could be argued that the definition of what good faith is or at least what it ought to achieve is contained in the five points. The only problem could arguably be that good faith is not capable of clear expression. However the question of clear expression is one of degrees and there are many principles in contract law such as ‘consideration’ which defy a clear physical expression or explanation.

In the end the question is what does the contract theory allow the courts to inquire into? Arguably the classical concept of contract law, which is based on an empirical premise that most contracts are discrete, has outlived its usefulness.<sup>95</sup> International contracts governed by conventions are recognizably not discrete in nature. They reflect or create relationships and hence can be termed ‘relational contracts’.<sup>96</sup> However such a distinction does not appear to be the solution either. Eisenberg, in his literature review on the subject came to the conclusion that the literature ‘has failed to show that there is a set of legal rules that should be applied to some contracts (relational) but not to others (non-relational).’<sup>97</sup> Eisenberg points out that the classical contract theory operates under the premise that the contract is for a homogeneous product concluded between two strangers who transact on a perfect spot market.<sup>98</sup> Given the background of classical contract theory it is understandable that principles such as the objective theory of

---

91 (1971) LR 6 QB 597, 607.

92 (1977) 180 CLR 266,283.

93 *Bilgola Enterprises Limited v Lampton Quay Books Limited & Ors* [2000] NZCA 113 (6 July 2000), 6.

94 *BP Refinery* above n 27, 283.

95 *Bobux Marketing Limited v Raynor Marketing Limited* [2001] NZCA 348 (3 October 2001), 35.

96 *Ibid.*

97 M Eisenberg in J Beatson, D Friedman (eds) *Good Faith and Fault in Contract Law* (1995), 291.

98 *Ibid* 296

interpretation and the parol evidence rule were developed. Today with internationalization of trade and globalisation such a theory is untenable and 'what made the classical contract theory infinitely worse was that its tacit empirical premise was wholly incorrect'.<sup>99</sup> Eisenberg defines relational contracts as based on the concepts of 'bargain and exchange' and therefore:

*A relational contract is a contract that involves not merely an exchange, but also a relationship, between the contracting parties.*<sup>100</sup>

The problem is not one of defining discrete or relational contracts but rather a review of contract theory. It is not a change of reality, which is needed but a change of the perception of the reality. In other words the judiciary needs to dislocate from the virtual contract theory and locate their thinking into an actual contract theory. It can be argued that Lord Ackner in *Walford v Miles*<sup>101</sup> based his assumption that parties to a contract are by definition adversarial in nature on the classical contract theory. Given that a relational contract is based on exchange and relationship the adversarial position is not a very credible one.

Importantly the observation has been made that 'most rules of English contract law conform with the requirements of good faith ... [and] it can be very firm in its treatment of those who act in bad faith'.<sup>102</sup> This proposition fails to take into consideration that good faith covers more than just expressions of bad faith. It would be extremely unusual if any legal system would tolerate bad faith behavior and therefore such an argument is flawed.

Mason J distinguished between two types of implied terms, namely implied terms necessary to give business efficacy to a contract or an 'implied term which is a legal incident of a particular class of contracts'.<sup>103</sup> In common law implied terms can be introduced through the process of rectification. However care must be taken to differentiate between the process of rectification and the 'mere' implication of a term. An implication of a term is based 'upon more general considerations'<sup>104</sup> and is designed to give effect to the parties' presumed intention whereas rectification ensures that the contract gives effect to the parties' actual intention.<sup>105</sup>

Arguably rectification is the only expression of subjective intent allowable in common law whereas the implication of terms generally relies on the objective

---

99 Ibid 297.

100 Ibid 296.

101 Above n 77.

102 E McKendrick above n 3,41.

103 Codelfa above n 82, 345.

104 Ibid 346.

105 Ibid.

theory. The combination of the objective principle and the parol evidence rule leaves little room to include the subjective approach, which is largely used in civil law countries as well as in several international instruments on contract law.<sup>106</sup>

It appears that technicalities of law are becoming more difficult to explain and sustain. As an example Lord Hoffmann in *Investors Compensation Scheme Limited v West Bromwich Building Society*<sup>107</sup> observed that:

*(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes the distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we should interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear.*<sup>108</sup>

If we consider that Bentham and his positivist followers valued certainty and predictability above all else,<sup>109</sup> the less than formalistic approach advocated by Lord Hoffmann does not contribute to certainty. On the other hand it is also not an invitation to judges to abandon established habits:

*“[and substitute] legally reasoned decisions [with] an unanalytical incantation of personal values which would lead to idiosyncratic and inconsistent decision making.”*<sup>110</sup>

Lord Hoffmann himself attempts to draw a distinction between legal interpretation and “interpretation of utterances in ordinary life.” He suggests that the “boundaries are in some respect unclear.” However is it not that these “utterances in ordinary life” are in many cases the foundation of a business relationship which leads to a contractual relationship? It is precisely the notion of subjective intent, which drives business and creates business contacts. In sum it leads to the formation of contracts. Whatever technological or legal advances we may have made, the selling and buying of goods is a personal activity. Good faith is arguably the particular function that can introduce the mechanism in which the legal framework can and will facilitate personalized contractual relationships.

An argument could be advanced that good faith is best suited to the subjective approach as it is an incident of personal relationships or an expression of expected

---

106 Article 8 CISG

107 [1998] 1 WLR 896.

108 Ibid, 912.

109 H K Lücke in P D Finn, (ed) *Essays on Contract* (1987), ‘Good Faith and Contractual Performance’, 155, 157.

110 Ibid 165.

behavior of the parties. Common law judges have given some attention to the effect of subjective intent on contract performance. May LJ remarked:

*For my part, I think that reference to the officious bystander frequently does not assist in deciding whether or not a term is to be implied. Officious bystanders may well take different views depending on which side they happen to be standing. In my judgment it is quite clear from such cases as Liverpool City Council v Irwin [1997] AC 239 that the real basis upon which a term can be implied in contracts such as this is that they are necessary in order to make the contract work<sup>111</sup>*

It is instructive to note that May LJ puts great emphasis on the fact that a court must have in mind that a contract needs to be made to work. Just to give effect to some rules, which may not have the effect of making a contract work is not conducive to a business relationship. That relationship after all is the base of contractual dealings.

As good faith is a ‘multi-purpose’<sup>112</sup> principle, the Common law has not yet taken full advantage of what this principle can offer specially in the incorporation of onerous terms into a contract. Bingham LJ acknowledged this point when he noted that:

*[I]n many civil law systems, and in most legal systems outside the common law world, the law of obligations recognizes and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. ... English law has characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.<sup>113</sup>*

Such an argument is not radical as a shift in thinking is in process. In 1975 Lord Wilberforce commented that:

*English law, having committed itself to a rather technical and schematic doctrine of contract, in application takes a practical approach, often at the cost of forcing the facts to fit uneasily into the marked slots of offer, acceptance and consideration.<sup>114</sup>*

It appears that a change away from the rather technical approach to contract law especially in relation to good faith is long overdue. Good faith once recognized

---

111 *Marcan Shipping (London) Ltd v Polish Steamship Co (The Manigest Lipkowsy)* [1998] 2 Lloyd’s Rep 138, 142.

112 *Ibid* 43.

113 *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433, 439.

114 *New Zealand Shipping Co Ltd v AM Satterthwaite & Co Ltd* [1975] AC 145, 167.

would challenge some of the present rules and may result in changes to substantive law.<sup>115</sup> It would be a reversal of rules as history shows that good faith has been an important principle in English law. Lord Mansfield remarked in *Carter v Boehm*<sup>116</sup> that good faith is the ‘governing principle ... applicable to all contracts and dealings’.<sup>117</sup> The time of the Law Merchant is being repeated in the form of globalization and the formalistic approach to contract law has arguably outlived its usefulness specially considering that the pillars of the classical theory namely predictability and certainty were illusory.<sup>118</sup>

The adoption of the implied term of good faith into international contract law and into domestic United States jurisprudence has not produced any evidence that the commercial transactions become uncertain or unworkable. The real stumbling block, it appears, is the elevation of good faith to the status of a general principle.<sup>119</sup> Therefore the mechanism of introducing implied terms into contracts is only of a secondary concern and can easily accommodate the introduction of good faith. The problem is that:

*In the absence of academic support at [this] critical stage in the development of English [and Australian] contract law, it was, perhaps rather optimistic to expect the creation of such a principle to emanate from the judges.*<sup>120</sup>

This does not suggest that judges can simply ignore the principle of good faith particularly as its inclusion in international contracts is a reality. Furthermore given that judges should apply good faith to a contract it is important that they not only understand what good faith means but that they also approach their task in good faith. In other words there must be an awareness and recognition that an obligation of good faith is not only imposed on parties to a contract but that the obligation is also extended to the judiciary. In international conventions an obligation to interpret the document in good faith is included and such an obligation can also be extended to the interpretation of a contract. After all the CISG and other such instruments do interpret contractual obligations by giving meaning to a contract. Just because such an obligation is embedded in a statute does not exclude its extension, at least by analogy into common law.

---

115 McKendrick above n 3, 44.

116 97 ER 1162.

117 Ibid, 1164.

118 A F Mason ‘Contract, Good Faith and Equitable Standards in Fair Dealing’ (2000) 116 LQR 66, 70.

119 E Mc Kendrick, above n 3, 46.

120 Ibid 47.

*Conclusion*

Despite being critical in establishing an implied duty of good faith Carlin notes that if parties included an express term of good faith into their contract 'a court should accommodate such an arrangement'.<sup>121</sup> Such a view in effect acknowledges that good faith is an established and defined principle in Australian jurisprudence. If good faith can be 'accommodated' as an express term such 'accommodation' can certainly be extended to implied terms. Arguably the real question is not what good faith actually means in an ultimate sense but rather whether courts are willing to apply good faith as an implied term.

In essence the debate can be summarized as follows:

*The question for the common law lawyers is, whether to develop an indigenous principle of good faith from existing specific rules appearing to be based upon it, or await the harmonization process as and when it comes, or to resist within that harmonization process the establishment of a general good faith concept.*<sup>122</sup>

The common law system is able, as Lord Mansfield demonstrated, to incorporate good faith into contract law but it needs to be seen whether the common law is able to develop an indigenous system. For domestic law to resist the establishment of a general principle of good faith is merely avoiding - in the short term only- the unavoidable. International conventions and the needs of business will drive the debate as to the principle of good faith. The international harmonization process is well established as most recent instruments such as the CISG, the UNIDROIT Principles and the Principles of European Contract Law all incorporated good faith as a foundational principle.

Unfortunately good faith is not a principle with a clear and precise meaning and therefore consideration must be given to the fact that good faith requires interpretation. To give substance to a term whether express or implied requires interpretation of concepts with the aid of relevant tools. Good faith is not only a legal term but by its very nature it also has a behavioral function. Courts can only fully understand the intent or parties if they inquire into the objective intent and also explore the subjective intent of parties as demonstrated in the CISG pursuant to article 8.

It is fitting to conclude with *Renard*, which started the debate on good faith. It has been argued that the contract was commercially effective without the implication of good faith as "Renard Construction had freely agreed with the minister that a

---

121 Carlin above n 18, 110.

122 Mac Queen, H. above n 3, 10.



notice to show cause could be issued for *any* default.”<sup>123</sup> But could they have foreseen when the contract was drawn up, that the minister later would take a decision under circumstances where he was not fully briefed? No individual or commercial entity can foresee all circumstances. The purpose of good faith is to act as a “leveller” which brings events into line, which were either subjectively or objectively agreed upon in the contract. The sheer volume of cases where courts are asked to rule on good faith indicates that contractual parties have embraced the concept of good faith and the “leap of faith” as discussed by Gummow J<sup>124</sup> is long overdue.

---

123 Baron above n 17, 25.

124 Gummow J in *Service Station Association Ltd v Berg & Associates Pty Ltd* [1993] 45 FCR 84 at 96.