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Dr MD Nahan, MLA
Chair
Economics and Industry Standing Committee
Parliament House
Perth, Western Australia, 6000



Dear Dr Nahan

Parliamentary Inquiry – Franchising Bill 2010

Our views on the inappropriateness of a legislated good faith obligation, whether in the *Franchising Code of Conduct* or discrete State based legislation, are set out in two papers attached to this email which we submit for your consideration.

The papers are:

‘Franchising and the Quest for the Holy Grail: Good Faith or Good Intentions?’, published in (2009) 33 *Melbourne University Law Review* 542;

‘Regulating the Franchise Relationship: Franchisor Opportunism, Commercial Morality and Good Faith’, to be published in Josef Windsperger (ed) *New Developments in the Theory of Networks*, Springer (2010).

These papers address good faith in the context of the current national regulatory scheme for franchising. The considerations are equally applicable to a State based regime which, in our strong opinion, would be a disturbing precedent and a very real threat to the vitality of the Australian franchising sector for which much credit is attributable to a single national regulatory scheme.

Yours sincerely

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FRANCHISING AND THE QUEST FOR THE HOLY GRAIL: GOOD FAITH OR GOOD INTENTIONS?

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[The recent Opportunity Not Opportunism: Improving Conduct in Australian Franchising report by the Parliamentary Joint Committee on Corporations and Financial Services (released December 2008) concluded that, while the prior disclosure obligations of Australia's regulatory instrument for franchising (the Franchising Code of Conduct) are for the most part adequately addressed, there remain concerns because of 'the continuing absence of an explicit overarching standard of conduct for parties entering a franchise agreement'. The Joint Committee recommended that the optimal way to address this concern, and thereby provide a deterrent against opportunistic conduct in the franchising sector, was 'to explicitly incorporate, in its simplest form, the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith'. This article analyses the scope and content of the existing implied obligation of good faith at common law and considers the implications for the franchise sector of a good faith obligation, were one to be incorporated into the Code.]

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I INTRODUCTION

In the time of the legendary King Arthur, the quest for the Holy Grail was the highest spiritual pursuit for a knight. Today, franchise reformers search for their own Holy Grail — a convenient formula to deliver balance and equity to the franchise relationship, which is commonly characterised by both power and information imbalances.¹ In Australia, there is a growing body of opinion that ‘good faith’ is the Holy Grail for the franchise sector and that a requirement that the parties to a franchise agreement act in good faith should be imposed² by amendment of the current regulatory instrument, the *Franchising Code of Conduct* (‘Code’)³ (which is prescribed under pt IVB of the *Trade Practices Act 1974* (Cth) as a mandatory industry code).⁴

While ‘good faith’ is a concept familiar to civil law jurisdictions,⁵ its application in common law jurisdictions is relatively new and is characterised by ‘twists and turns in [its] ongoing development’.⁶ Brereton J recently observed that ‘the implication of a term ... [of] good faith does not fit neatly into the structure of Australian contract law’.⁷ In the United States of America, the *Uniform Commercial Code* provides in § 1-304 that ‘[e]very contract or duty within [the *Uniform Commercial Code*] imposes an obligation of good faith in its performance and enforcement’.⁸ Franchising has generally been held to be subject to this standard.⁹ An implied covenant of good faith and fair dealing is

¹ Franchising is a significant business relationship in Australia, with a sales turnover in 2007 estimated at \$130 billion: Lorelle Frazer, Scott Weaven and Owen Wright, Asia-Pacific Centre for Franchising Excellence, *Franchising Australia 2008 — Survey* (2008) 10 <http://www.griffith.edu.au/data/assets/pdf_file/0008/101051/fa2008-web-version.pdf>. The *Franchising Australia 2008 — Survey* found 1100 business-format franchise systems operating in Australia in 2008 (a growth rate of 14.6 per cent from the previous survey in 2006) and a total of 71 400 business units (63 500 franchised and 7900 company owned — a growth rate of 15.4 per cent from 2006): at 9–10. The survey also found that 413 000 people were employed in business-format franchise systems in 2008: at 10.

² See generally Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Opportunity Not Opportunism: Improving Conduct in Australian Franchising* (2008) (‘*Opportunity Not Opportunism Report*’). Chapter 8 of the report noted numerous submissions supporting (and opposing) the case for the incorporation of a standard of good faith in the *Franchising Code of Conduct*.

³ *Trade Practices (Industry Code — Franchising) Regulations 1998* (Cth) sch (‘*Franchising Code of Conduct*’).

⁴ *Trade Practices (Industry Code — Franchising) Regulations 1998* (Cth) reg 3.

⁵ See E Allan Farnsworth, ‘Good Faith Performance and Commercial Reasonableness under the *Uniform Commercial Code*’ (1963) 30 *University of Chicago Law Review* 666, 669–70, who outlines the classical origins of the ‘venerable shibboleth’ of good faith in Roman law and its passage into the English common law.

⁶ Bill Dixon, ‘Can the Common Law Obligation of Good Faith Be Contractually Excluded?’ (2007) 35 *Australian Business Law Review* 110, 110.

⁷ *Hunter Valley Skydiving Centre Pty Ltd v Central Coast Aero Club Ltd* [2008] NSWSC 539 (Unreported, Brereton J, 3 June 2008) [48].

⁸ *Uniform Commercial Code* § 1-304 (2004).

⁹ See, eg, *Zapatha v Dairy Mart Inc*, 381 Mass 284, 289 fn 7, 291 (Wilkins J for Hennessey CJ, Quirico, Braucher, Wilkins and Abrams JJ) (1980).

also articulated in § 205 of the *Restatement (Second) of Contracts*.¹⁰ Thomas Pitegoff and Michael Garner nevertheless suggest that:

Although the 'covenant' of good faith and fair dealing probably is law in most jurisdictions, there are very few cases where that principle, by itself, has led to a ruling favourable to a franchisee. Several courts have held that no cause of action exists for an alleged violation of the covenant in the absence of an allegation of violation in bad faith of an express term of the agreement.¹¹

In the United Kingdom, franchise agreements are not subject to overarching and overriding duties of good faith under the common law.¹² The application of 'non-derogation from grant' property law principles in a franchising context in *Fleet Mobile Tyres Ltd v Stone* ('*Stone*')¹³ nevertheless suggests that 'good faith' may emerge under another guise. In Canada, a duty of good faith exists at common law in the context of a franchise relationship¹⁴ and is codified in the franchise laws of Alberta, New Brunswick, Ontario, and Prince Edward Island.¹⁵

Australia has had four government inquiries into the franchise sector and its regulation in the last two years.¹⁶ Three of the four reports recommended the introduction of a good faith obligation.

The *Review of the Disclosure Provisions of the Franchising Code of Conduct* ('*Matthews Report*') of October 2006 noted that 'interdependency between franchisors and franchisees is fundamental to the franchise sector' and

consider[ed] that recognition in the *Code* of a concept of good faith and fair dealing would provide positive reinforcement to the development of improved relationships and dealings between franchisors, franchisees and prospective franchisees.¹⁷

The report recommended that a 'statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be

¹⁰ *Restatement (Second) of Contracts* § 205 (1981) states that '[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.'

¹¹ Thomas M Pitegoff and W Michael Garner, 'Franchise Relationship Laws' in Rupert M Barkoff and Andrew C Seldon (eds), *Fundamentals of Franchising* (3rd ed, 2008) 183, 224 (citations omitted).

¹² See *Jani-King (GB) Ltd v Pula Enterprises Ltd* [2008] 1 All ER (Comm) 451, 466–7 (Judge Coulson).

¹³ [2006] EWCA Civ 1209 (Unreported, Keene, Wall and Wilson LJ, 31 August 2006).

¹⁴ See, eg, *Shelanu Inc v Print Three Franchising Corporation* (2003) 64 OR (3d) 533, 540 (Weiler JA for Weiler, Austin and Laskin JJA) (Ontario Court of Appeal) ('*Shelanu*'). See also Shannon Kathleen O'Byrne, 'The Implied Term of Good Faith and Fair Dealing: Recent Developments' (2007) 86 *Canadian Bar Review* 193, 218.

¹⁵ *Franchises Act*, RSA 2000, c F-23, s 7 (Alberta); *Franchises Act*, SNB 2007, c F-23.5, ss 3(1), (3) (New Brunswick); *Arthur Wishart Act (Franchise Disclosure)*, SO 2000, c 3, ss 3(1), (3) (Ontario); *Franchises Act*, RSPEI 1988, c F-14.1, ss 3(1), (3) (Prince Edward Island).

¹⁶ See Franchising Code Review Committee, *Review of the Disclosure Provisions of the Franchising Code of Conduct — Report to the Hon Fran Bailey MP* (2006) ('*Matthews Report*'); Government of Western Australia, *Inquiry into the Operation of Franchise Businesses in Western Australia — Report to the Western Australian Minister for Small Business* (2008); Economic and Finance Committee, Parliament of South Australia, *Final Report — Franchises*, Report No 65 (2008) ('*South Australian Report*'); *Opportunity Not Opportunism Report*, above n 2.

¹⁷ *Matthews Report*, above n 16, 47.

developed for inclusion in Part 1 of the *Code*.¹⁸ The government's response in February 2007 was parsimonious. It 'agree[d] with the intention' that franchise participants 'act towards each other fairly and in good faith' but simply noted that s 51AC of the *Trade Practices Act 1974* (Cth) — the business unconscionability provision — 'includes "good faith" as a factor that can be taken into account when determining' whether a party has acted unconscionably.¹⁹

The *Final Report — Franchises* ('*South Australian Report*') was of the opinion that 'there currently exist unacceptable limits on the ability of the franchisees to seek redress in cases where franchisors abuse their contractual discretions and powers.'²⁰ The Economic and Finance Committee of the South Australian Parliament recommended amending the *Code* by inserting a provision imposing 'a duty to act in accordance with good faith and fair dealing [on] each party of the franchise relationship.'²¹

The latest and most influential report²² — *Opportunity Not Opportunism: Improving Conduct in Australian Franchising* ('*Opportunity Not Opportunism Report*') by the Parliamentary Joint Committee on Corporations and Financial Services (released December 2008) — concluded that, while the *Code*'s prior disclosure obligations 'have been, for the most part, adequately addressed by past inquiries, there remains concern ... [because of] the continuing absence of an explicit overarching standard of conduct for parties entering a franchising agreement.'²³ The report noted that:

the interdependent nature of the franchise relationship leaves the parties to the agreement vulnerable to opportunistic conduct by either franchisors or franchisees. Franchisee opportunism may take the form of free riding, unauthorised use of franchisors' intellectual property rights, underperformance, or failure to accurately disclose income. However, the franchisor's control over the provisions in the contract enables franchisors to address opportunistic behaviour of this kind by enforcing the terms of the franchise agreement.

Franchisor opportunism has been described as 'predatory conduct and strong arm tactics by franchisors' involving the exploitation of a pre-existing power relationship between the franchising parties, which makes the franchisee 'vulnerable or economically captive to the demands of the franchisor'. There is an inherent and necessary imbalance of power in franchise agreements in favour of the franchisor, but abuse of this power can lead to opportunistic practices in-

¹⁸ Ibid (recommendation 25).

¹⁹ Australian Government, *Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct* (2007) 9 <<http://www.innovation.gov.au/Section/SmallBusiness/Pages/FranchisingCodeofConduct.aspx>>.

²⁰ *South Australian Report*, above n 16, 59.

²¹ Ibid 60, 98.

²² The *Opportunity Not Opportunism Report*, above n 2, is the most comprehensive report — a 125-page report containing 11 significant recommendations. The Joint Committee received approximately 170 submissions, held public hearings across the country and heard from over 50 witnesses: see at 127–35. It also had the benefit of the accumulated wisdom, or otherwise, of the earlier reports. And the federal report was always going to be the most influential given that the *Code* is a federal responsibility.

²³ Ibid 101 (citations omitted).

cluding encroachment, kickbacks, churning, non-renewal, transfer, termination at will, and unreasonable unilateral variations to the agreement.²⁴

The Joint Committee's conclusion was

that the optimal way to provide a deterrent against opportunistic conduct in the franchising sector is to explicitly incorporate, in its simplest form, the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith.²⁵

The Joint Committee recommended that the following new clause be inserted into the *Code*:

6 Standard of Conduct

Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.²⁶

This article examines the common law developments in relation to an implied obligation of good faith, the elusive nature of its scope and meaning, and the implications for the franchise sector if a good faith obligation were to be enacted.

II GOOD FAITH AND THE FRANCHISE RELATIONSHIP

Outside legislative direction, an obligation of good faith can arise in a franchise agreement in three ways — as an express term of the contract,²⁷ as a term implied in fact on an ad hoc basis to give business efficacy to the contract,²⁸ or as a term implied in law as a necessary incident of the contract.²⁹ A fourth possibility is that the obligation of good faith is a principle of construction which is 'inherent in all common law contract principles,' meaning that the implication of 'independent term[s] requiring good faith is unnecessary and a retrograde step.'³⁰ This argument was strongly contested by Bergin J in *Insight Oceania Pty Ltd v Philips Electronics Australia Ltd* ('*Insight Oceana*') on the basis that '[i]t is erroneous to suggest that the modern approach to the construction of contracts, whether one refers to it as commercial construction or otherwise, is driven by a concern "to ensure good faith".'³¹ Bergin J did not refer to, but is strongly supported by, the decision of the Court of Appeal of New South Wales in

²⁴ Ibid (citations omitted).

²⁵ Ibid 114.

²⁶ Ibid 115 (recommendation 8).

²⁷ See, eg, *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [140], [148], [353] ('*Automasters*').

²⁸ See, eg, *Kellcove Pty Ltd v Australian Motor Industries Ltd* (Unreported, Federal Court of Australia, Woodward J, 6 July 1990) 139–41; *Laurelmount Pty Ltd v Stockdale & Leggo (Queensland) Pty Ltd* [2001] QCA 212 (Unreported, McPherson, Williams JJA and Dutney J, 5 June 2001) [46] (Dutney J).

²⁹ See, eg, *Del Casale v Artdomus (Aust) Pty Ltd* (2008) 73 IPR 326, 345 (Campbell JA).

³⁰ J W Carter, Elisabeth Peden and G J Tolhurst, *Contract Law in Australia* (5th ed, 2007) 21.

³¹ [2008] NSWSC 710 (Unreported, Bergin J, 23 July 2008) [173], aff'd [2009] NSWCA 124 (Unreported, Tobias, Campbell and Macfarlan JJA, 28 May 2009). *Contra* Elisabeth Peden, "'Implicit Good Faith' — Or Do We Still Need an Implied Term of Good Faith?" (2009) 25 *Journal of Contract Law* 50.

Vodafone Pacific Ltd v Mobile Innovations Ltd ('Vodafone'), which held that an obligation of good faith is implied in law 'and does not proceed on a fiction that an intention of the parties is being found by a process of construction'.³²

There is increasing judicial support, albeit not at the highest levels of the judicial hierarchies, for a term of good faith to be implied in law as a necessary incident of a commercial contract.³³ In 1999, Finkelstein J of the Federal Court of Australia stated in *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* ('Garry Rogers') that 'in appropriate contracts, perhaps even in all commercial contracts, such a term will ordinarily be implied; not as an ad hoc term (based on the presumed intention of the parties) but as a legal incident of the relationship'.³⁴ In 2001, the NSW Court of Appeal in *Burger King Corporation v Hungry Jack's Pty Ltd* ('Burger King (Appeal)') was also of the opinion that a duty of good faith should be implied in law.³⁵ In *Overlook Management BV v Foxtel Management Pty Ltd* ('Overlook'), Barrett J in the Supreme Court of New South Wales went so far as to state that 'a term requiring the exercise of good faith in the performance' of a commercial contract 'is now in [NSW] a legal incident of every such contract'.³⁶

This view has wide — albeit not unanimous — support throughout Australia. Despite the support of the NSW Court of Appeal in *Burger King (Appeal)*, a differently constituted Court of Appeal³⁷ in *Vodafone* stated that it did 'not think the law has yet gone so far as to say that commercial contracts are a class of contracts carrying the implied terms as a legal incident, and the width and indeterminacy of the class of contracts would make it a large step'.³⁸

In *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* ('Esso Australia'),³⁹ the Court of Appeal of Victoria expressed reluctance — or, in the words of Dodds-Streton J in a later case, 'evinced a reserved approach'⁴⁰ — to

³² [2004] NSWCA 15 (Unreported, Sheller, Giles and Ipp JJA, 20 February 2004) [206] (Giles JA); see also at [1] (Sheller JA), [342] (Ipp JA).

³³ Cf *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1, 208–9 (emphasis in original), where Finn J noted that '[t]here is not yet agreement in this country as to the province of good faith in contract law' and that while '[s]ome ... consider that the duty of good faith and fair dealing should apply to all contracts', others 'see it as a legal incident of particular classes of contract'.

³⁴ [1999] ATPR ¶41-703, 43 014. The recent cases which Finkelstein J regarded as making this proposition 'clear' were *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151 ('Hughes') and *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 ('Alcatel').

³⁵ (2001) 69 NSWLR 558, 573 (Sheller, Beazley and Stein JJA).

³⁶ [2002] Aust Contract Reports ¶90-143, 91 970, citing *ibid*.

³⁷ *Burger King (Appeal)* (2001) 69 NSWLR 558 was a joint judgment of Sheller, Beazley and Stein JJA. In *Vodafone* [2004] NSWCA 15 (Unreported, Sheller, Giles and Ipp JJA, 20 February 2004) [1] (Sheller JA), [342] (Ipp JA), Sheller and Ipp JJA agreed with the judgment of Giles JA.

³⁸ [2004] NSWCA 15 (Unreported, Sheller, Giles and Ipp JJA, 20 February 2004) [191] (Giles JA). His Honour was nevertheless 'content to assume, expressly without deciding, that unless excluded by express provision or because inconsistent with the terms of the contract, Vodafone was under an implied obligation to act in good faith and reasonably in exercising its powers' under the agreement.

³⁹ [2005] VSCA 228 (Unreported, Warren CJ, Buchanan JA and Osborn AJA, 15 September 2005).

⁴⁰ *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd* [2006] VSC 223 (Unreported, Dodds-Streton J, 21 June 2006) [205].

endorsing the implication of a term of good faith as a legal incident of commercial contracts. Buchanan JA (with whom Warren CJ and Osborn AJA agreed) expressed a preference for 'ad hoc implication meeting the tests laid down in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*,⁴¹ rather than implication as a matter of law creating a legal incident of contracts of a certain type.⁴² Buchanan JA nevertheless qualified his reservations:

I am reluctant to conclude that commercial contracts are a class of contracts carrying an implied term of good faith as a legal incident, so that an obligation of good faith applies indiscriminately to all the rights and powers conferred by a commercial contract. It may, however, be appropriate in a particular case to import such an obligation to protect a vulnerable party from exploitative conduct which subverts the original purpose for which the contract was made.⁴³

Franchising is of course an example of a commercial contract in which a vulnerable party may be susceptible to exploitative conduct.⁴⁴

Warren CJ, in the same case, noted that, even if a term of good faith *could* arise as legal incident of a commercial contract, it would not arise in every case:

Ultimately, the 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. 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.⁴⁵

These issues are yet to be addressed by the High Court of Australia. In *Royal Botanic Gardens and Domain Trust v South Sydney City Council* ('*Royal Botanic Gardens*'), questions were raised by the 'rather far-reaching contentions of the appellant' as to

whether both in performing obligations and exercising rights under a contract, all parties owe to one another a duty of good faith; and, the extent to which, if such were to be the law, a duty of good faith might deny a party an opportunistic or commercial exercise of an otherwise lawful commercial right.⁴⁶

Unfortunately for the development of the law in this difficult area, it was unnecessary in the appeal for the High Court to explore these questions further. Kirby J nevertheless observed that:

⁴¹ (1977) 180 CLR 266 (Privy Council).

⁴² *Eso Australia* [2005] VSCA 228 (Unreported, Warren CJ, Buchanan JA and Osborn AJA, 15 September 2005) [25] (Buchanan JA); see also at [1] (Warren CJ), [32] (Osborn AJA).

⁴³ *Ibid* [25] (citations omitted).

⁴⁴ See generally Gillian K Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927; Andrew Terry, 'Franchising, Relational Contracts and the *Vibe*' (2005) 33 *Australian Business Law Review* 289.

⁴⁵ *Eso Australia* [2005] VSCA 228 (Unreported, Warren CJ, Buchanan JA and Osborn AJA, 15 September 2005) [4].

⁴⁶ (2002) 186 ALR 289, 327 (Callinan J).

The court was taken to case law both in [Australia] and overseas as well as to academic commentary to demonstrate a growing tendency to imply into private contractual dealings a covenant of good faith and fair dealing. As expressed in some United States decisions, this is a principle that is not confined to an obligation to exercise express contractual powers fairly and reasonably. In some parts of the United States, the obligation has been accepted as a general implied contractual term in its own right.⁴⁷

Although it was not necessary in the appeal to explore these issues, Kirby J does not provide great comfort to those who argue that good faith imposes an overarching ethical obligation:

in Australia, such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include.⁴⁸

Although the propositions supporting the implication of an obligation of good faith as a necessary incident of the contract have generally been expressed in relation to 'commercial contracts', the case for implication of a term as a necessary incident of franchise contracts is much stronger given their relational nature. In the academic literature, the case for the implication of good faith is based on the recognition of the special circumstances present in *relational* contracts.⁴⁹ In one of the very few judicial references to 'relational contracts' in Australasia, a New Zealand appellate judge described such contracts in these terms:

In essence, relational contracts recognise the existence of a business relationship between the parties and the need to maintain that relationship; the difficulty of reducing important terms to well-defined obligations; the impossibility of foretelling all the events which may impinge upon the contract; the need to adjust the relationship over time to provide for unforeseen factors or contingencies which cannot readily be provided for in advance; the commitment, likely to be extensive, which one party must make to the other, including significant investment; and that they are in an economic sense likely to be incomplete in failing to allocate, or allocate optimally, the risk between the parties in the event of certain future contingencies. ...

Consequently, a relational contract is one which involves not merely an exchange but a relationship between the contractual parties. The parties are not 'strangers' in the accepted sense and much of their interaction takes place 'off the contract' requiring a deliberate measure of communication, cooperation, and predictable performance based on mutual trust and confidence. Expecta-

⁴⁷ Ibid 311–12 (citations omitted).

⁴⁸ Ibid 312 (citations omitted).

⁴⁹ See generally Hadfield, above n 44; Terry, above n 44; Bill Dixon, 'Common Law Obligations of Good Faith in Australian Commercial Contracts — A Relational Recipe' (2005) 33 *Australian Business Law Review* 87.

tions of loyalty and interdependence mark the formation of the contract and become the basis for the rational economic planning of the parties.⁵⁰

In the academic literature, the 'doctrinal tool' relied on 'to bring the resolution of franchise contract disputes into line with the realities of the franchise relation[ship]' is invariably the implied term of good faith.⁵¹ Perhaps surprisingly, the express judicial pronouncements stating that good faith is a necessary incident of a 'commercial contract' are not supported by any doctrinal underpinning, although it has been argued that a relational 'vibe', albeit unexpressed and unacknowledged, lurks not far below the surface of the judgments.⁵²

Unlike classical, discrete 'spot ... contracts',⁵³ which might be seen as 'episodic arm-wrestles for economic advantage',⁵⁴ many modern contractual arrangements involve 'co-operative ventures, based on interpersonal relationships in which many of the important undertakings remain unspecified.'⁵⁵ The franchise contract enshrines such a relationship. In the typical business-format franchise agreement, relational considerations feature prominently. As Gillian Hadfield argues convincingly, franchising exists in a 'world of contractual incompleteness and relational complexity'.⁵⁶ Elizabeth Spencer notes that in franchise relationships the unequal bargaining power and lack of negotiation of the standard form, combined with the relational contract's reliance on flexibility and trust, strongly reinforce the imbalance of power.⁵⁷ But while the categorisation of franchising as a relational contract seems straightforward, the legal consequences that follow from this categorisation are highly controversial. Hadfield argues that the point of departure from traditional contract law is that 'when a contract is embedded within an identifiable relationship, such as the franchise relationship, contractual obligations are often modified, supplemented or completely supplanted by the norms of the ongoing relation.'⁵⁸ The extent to which these commercial realities of the franchise relationship should be accommodated legally, and whether good faith is the appropriate doctrine through which to do so, thus pose a challenge for the courts and legislators alike.

⁵⁰ *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002] 1 NZLR 506, 516–17 (Thomas J) ('Bobux'), adopted in *Gough & Gilmour Holdings Pty Ltd v Caterpillar of Australia Ltd [No 11]* [2002] NSWIRComm 354 (Unreported, Boland J, 19 December 2002) [54]. Thomas J was dissenting: see *Bobux* [2002] 1 NZLR 506, 508, 518.

⁵¹ Hadfield, above n 44, 984.

⁵² Terry, above n 44.

⁵³ Veronica L Taylor, 'Contracts with the Lot: Franchises, Good Faith and Contract Regulation' [1997] *New Zealand Law Review* 459, 467.

⁵⁴ *Ibid* 466.

⁵⁵ *Ibid*.

⁵⁶ Hadfield, above n 44, 928.

⁵⁷ Elizabeth Crawford Spencer, Submission No 39 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Franchising Code of Conduct*, 2 September 2008, 9–12.

⁵⁸ Hadfield, above n 44, 929 (citations omitted).

III GOOD FAITH AND RELATED DOCTRINES

The idea of 'good faith' as a guiding principle permeates several accepted legal duties and concepts. The common law duty to cooperate, the doctrine of non-derogation from grant and the unconscionability regime may be argued to cover the field to such a degree that a separate concept of good faith is an unnecessary addition to Australian contract law. Further, as Gummow J stated in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (in relation to specific equitable interventions in Anglo-Australian contract law where notions of good conscience play a part), 'it requires a leap of faith to translate these well-established doctrines and remedies into a new term as to the quality of contractual performance, implied by law.'⁵⁹

A The Common Law Duty to Cooperate

John Carter, Elisabeth Peden and Greg Tolhurst — critics of the recognition of a separate implied duty of good faith at common law — argue that '[g]ood faith is inherent in all common law contract principles, and any attempt to imply an independent term requiring good faith is unnecessary and a retrograde step.'⁶⁰ Peden argues that good faith is simply a principle which infuses contract law by requiring parties to do all that is reasonably necessary to facilitate performance of a contract:

'Cooperation' is sometimes seen as equivalent to 'good faith', and this seems appropriate. The effect of requiring cooperation often overlaps with what is trying to be achieved by the newly created obligation of 'good faith'. Cooperation (or good faith, if that term is preferred) basically must embrace a duty to act honestly and a duty to have regard to the legitimate interests of the other party.⁶¹

In *Insight Oceania*, Bergin J was dismissive of this approach, arguing that '[i]f the authors did intend to convey that the parties to every contract are contractually bound to act in good faith, it is not consistent with the state of the present law'.⁶² A review of the case law nevertheless provides some support for Peden's view that good faith as it has been applied in the cases often overlaps with an approach based on the undisputed duty of cooperation and that cooperation could have achieved the same result without recourse to an undefined standard of good faith.⁶³ However, the question as to whether the duty to cooperate achieves the goals espoused by proponents of good faith as a separate duty must still be asked.

In the oft-cited case of *Mackay v Dick*, Lord Blackburn stated that:

⁵⁹ (1993) 45 FCR 84, 97.

⁶⁰ Carter, Peden and Tolhurst, above n 30, 21.

⁶¹ Elisabeth Peden, *Good Faith in the Performance of Contracts* (2003) 170 (citations omitted).

⁶² [2008] NSWSC 710 (Unreported, Bergin J, 23 July 2008) [174]. See also *Vodafone* [2004] NSWCA 15 (Unreported, Sheller, Giles and Ipp JJA, 20 February 2004) [191] (Giles JA).

⁶³ See Peden, *Good Faith in the Performance of Contracts*, above n 61, 139–41.

where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect. What is the part of each must depend on circumstances.⁶⁴

Griffith CJ in *Butt v M'Donald* restated Lord Blackburn's pronouncement as follows:

It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract.⁶⁵

Cooperation appears to require a commitment only to the terms of the contract and whatever lies pregnant within them for the purpose of performance; it does not necessarily require concern to be had for any of the other party's legitimate interests or expectations that, due to their nature, might not have been expressed in a standard form contract or that may have developed over time without their reduction into certain contractual terms. Because the duty to cooperate operates in the context of the terms of the contract, there is no scope for it to create an independent source of rights (which the proponents of good faith would require).

For these reasons, a requirement of good faith may be thought to hold some promise in bringing balance to the negative potentialities of the franchise relationship, as it may take account of broader concerns beyond the hard terms of a contract. However, the simple duty to cooperate might fail to assist a party to a franchise agreement except in clear cut cases of contractual evasion, frustration and non-performance. This is especially so if an experienced franchisor leaves nothing for the duty of cooperation to work on to the franchisee's benefit in a standard form contract weighted in favour of and intentionally silent about the responsibilities of the franchisor.

B *Non-Derogation from Grant*

In *Birmingham, Dudley & District Banking Co v Ross*, Bowen LJ said that the principle that a grantor must not derogate from a grant made appeared to be 'as old, I will not say as the hills, but as old as the Year Books, and a great deal older.'⁶⁶ In *Molton Builders Ltd v City of Westminster London Borough Council*, Lord Denning MR commented that non-derogation from grant

is a general principle of law that, if one man agrees to confer a particular benefit on another, he must not do anything which substantially deprives the other of the enjoyment of that benefit: because that would be to take away with one hand what is given with the other.⁶⁷

⁶⁴ (1881) 6 App Cas 251, 263.

⁶⁵ (1896) 7 QJ 68, 70-1.

⁶⁶ (1888) 38 Ch D 295, 312.

⁶⁷ (1975) 30 P & CR 182, 186.

Nicholls LJ in *Johnston & Sons Ltd v Holland* states that, '[a]s one would expect, the principle applies to all forms of grants.'⁶⁸ While English law does not recognise good faith as an implied obligation,⁶⁹ the Court of Appeal has recently applied the non-derogation from grant doctrine in the franchising context for the benefit of a franchisee. In *Stone*, the introduction of an e-commerce model impacted adversely on a franchisee's business.⁷⁰ Although the franchisor was not prevented from implementing such a model by the franchise agreement (which did not contain provisions relating to internet sales),⁷¹ the Court of Appeal held that this amounted to substantial impairment of the franchisee's enjoyment of the rights acquired under the franchise agreement and thus amounted to a derogation from the grant:

The agreement, when read as a whole, cannot be construed as entitling the claimant [the franchisor] to impose such far-reaching restrictions on the franchisee's ability to promote that part of the business where he [the franchisee] set the sale price directly with the customer.⁷²

In Australia, the non-derogation from grant doctrine was recently considered in *JLCS Pty Ltd v Squires Loft City Steakhouse Pty Ltd* ('*Squires Loft*').⁷³ In that case, a restaurant licensee argued that an implied term existed in the licence

⁶⁸ [1988] 1 EGLR 264, 267, quoted in *Secure Parking (WA) Pty Ltd v Wilson* [2008] WASCA 268 (Unreported, Martin CJ, Buss JA and Murray AJA, 19 December 2008) [95] (Buss JA) ('*Secure Parking*'). This principle was applied by the House of Lords in *British Leyland Motor Corporation Ltd v Armstrong Patents Co Ltd* [1986] AC 577, 643 (Lord Templeman), a case which concerned the reliance on copyright in car parts to prevent purchase of replacement parts from other vendors. In *Secure Parking* [2008] WASCA 268 (Unreported, Martin CJ, Buss JA and Murray AJA, 19 December 2008) [96], Buss JA documents the recent course of the principle at the level of the High Court of Australia:

In *Concrete Pty Ltd v Parramatta Design & Developments Pty Ltd* [(2006) 229 CLR 577] ..., Kirby and Crennan JJ applied the doctrine of non-derogation from grant in the context of copyright licensing [at 606–7] ... By contrast, Gummow ACJ reserved for further consideration any application of that doctrine in the field of copyright licensing and, also, the applicability in Australia of the reasoning in *Solar Thomson Engineering Co Ltd v Barton* [1977] RPC 537 and *British Leyland Motor Corporation Ltd v Armstrong Patents Co Ltd* [1986] AC 577. Hayne and Callinan JJ found it unnecessary to deal with the point.

⁶⁹ *Jani-King (GB) Ltd v Pula Enterprises Ltd* [2008] 1 All ER (Comm) 451, 466–7 (Judge Coulson).

⁷⁰ [2006] EWCA Civ 1209 (Unreported, Keene, Wall and Wilson LJ, 31 August 2006) [3], [18], [20]–[23], [43]–[45] (Keene LJ).

⁷¹ See *ibid* [7]–[17].

⁷² *Ibid* [57]; see also at [60] (Wall LJ), [61] (Wilson LJ). The franchisor's e-commerce system had a different brand name, and the prices for work that originated from this e-commerce system were fixed by the franchisor (on its website); the prices for other customers were set by the franchisee itself: at [3], [19]–[20] (Keene LJ). The franchisor attempted to use provisions of the franchise agreement to require the franchisee to complete jobs received via the e-commerce system and to promote the e-commerce brand above the original (non e-commerce) brand: at [22].

⁷³ (2008) 78 IPR 319. Apart from being mentioned in passing in *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 (Unreported, Byrne J, 18 August 2000) ('*Far Horizons*'), the concept of non-derogation from grant has not arisen in Australian franchising cases involving good faith. In *Far Horizons*, at [128] (citations omitted), Byrne J stated that:

The contractual terms [sought to be implied by the franchisee] ... appear to be manifestations of the general obligation imposed on a party to a contract 'to do all the things as are necessary on his part to enable the other party to have the benefit of the contract' and not to do anything which will derogate from the benefit of the contract.

which would provide a measure of protection of the goodwill generated from the use of a trademark in circumstances where the licensor proposed to license a restaurant operating under the same name within 500 metres.⁷⁴ Finkelstein J held that the principle of non-derogation from grant, while originally developed in relation to property and leasing cases, could be applied in a wider context,⁷⁵ which demonstrates increased recognition of the applicability of the concept to relational disputes. Finkelstein J inquired into the purpose of the grant of the licence and relied upon the fact that opening up another restaurant of similar name in close proximity to the existing one would 'unduly interfere' with the rights inherent in that grant by the licensor.⁷⁶ In a practical sense, this meant an obligation existed by which JLCS was 'not to use, or permit the use of, the Squires Loft name in a location so proximate to the [licensee's] city restaurant that it would likely result in a significant adverse effect on the goodwill' of the licensee's operation.⁷⁷

The purpose of the doctrine is therefore to protect the spirit of the bargain struck. Based on current expectations of what a duty of good faith would achieve, the doctrine of non-derogation from grant could potentially cover the field and provide the knights of good faith with what they seek. The application of this doctrine in the franchise context in *Stone* and *Squires Loft* demonstrates that it may provide a better mechanism than an undefined, imprecise good faith obligation for dealing with a range of 'good faith' disputes in franchising, particularly in an encroachment context. However, due to the scarcity of case law, particularly superior court authority in Australia, the development of the non-derogation from grant doctrine in the franchise context is very much a work in progress.

C Unconscionability

In *Shelanu Inc v Print Three Franchising Corporation*, the Court of Appeal for Ontario quoted Paul Finn (now Finn J of the Federal Court of Australia):

'Unconscionability' accepts that one party is entitled as of course to act self-interestedly in his actions towards the other. Yet in deference to that other's interests, it then proscribes excessively self-interested or exploitative conduct. 'Good faith', while permitting a party to act self-interestedly, nonetheless qualifies this by positively requiring that party, in his decision and action, to have regard to the legitimate interests therein of the other. The 'fiduciary' standard for its part enjoins one party to act in the interests of the other — to act selflessly and with undivided loyalty. There is, in other words, a progression from the first to the third: from selfish behaviour to selfless behaviour. Much

⁷⁴ *Squires Loft* (2008) 78 IPR 319, 326 (Finkelstein J).

⁷⁵ *Ibid.*

⁷⁶ *Ibid* 327.

⁷⁷ *Ibid.* Interestingly, the non-derogation from grant doctrine does not seem to have been raised by the parties but by Finkelstein J, who stated: 'Harold and Saul [the directors of the licensee] have not sought relief based on the rule that a person may not derogate from his grant. Were they to apply to amend their cross-claim to include relief in that regard I would accede to the application.'

the most contentious of the trio is the second, 'good faith'. It often goes unacknowledged. It does embody characteristics to be found in the other two.⁷⁸

While the above statement envisages a continuum, clear dividing lines between concepts along that continuum are seldom provided. In *Renard Constructions (ME) Pty Ltd v Minister for Public Works* ('Renard'), Priestley JA stated that 'there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability'.⁷⁹ While legislation in the form of s 51AC of the *Trade Practices Act 1974* (Cth) (which prohibits unconscionable conduct in business transactions) is not limited to equitable principles of unconscientiously exploiting a special disadvantage,⁸⁰ the courts have come to different understandings of what constitutes 'unconscionability'.⁸¹ While the word itself connotes unscrupulous conduct which is undertaken without regard to conscience (for example, the franchisor's actions in *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd*, where unconscionability was indicated by 'an overwhelming case of unreasonable, unfair, bullying and thuggish behaviour'),⁸² some courts have equated the concepts of unconscionability and good faith.⁸³

The already unclear delineation between the concepts of unconscionability and good faith is further blurred by the 'extent to which the supplier and the business consumer acted in good faith' being one of the relevant factors a court may consider in its determination of whether conduct is unconscionable under s 51AC.⁸⁴ While this suggests a link between good faith and unconscionability, an absence of good faith is not determinative, but simply one of the twelve

⁷⁸ (2003) 64 OR (3d) 533, 555–6 (Weiler JA for Weiler, Austin and Laskin JJA), quoting P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) 1, 4.

⁷⁹ (1992) 26 NSWLR 234, 265.

⁸⁰ Cf *Australian Competition and Consumer Commission v C G Berbatis Holdings Pty Ltd* (2003) 214 CLR 51 in relation to s 51AA of the *Trade Practices Act 1974* (Cth), which does operate upon such principles.

⁸¹ See generally Senate Standing Committee on Economics, Parliament of Australia, *The Need, Scope and Content of a Definition of Unconscionable Conduct for the Purposes of Part IVA of the Trade Practices Act 1974* (2008), which addressed difficulties surrounding the definition of unconscionability.

⁸² (2000) 104 FCR 253, 270 (Sundberg J).

⁸³ See, eg, *Alcatel* (1998) 44 NSWLR 349, 368 (Sheller JA), citing *Pierce Bell Sales Pty Ltd v Frazer* (1973) 130 CLR 575, 587 (Barwick CJ):

If a contract confers power on a contracting party in terms wider than necessary for the protection of the legitimate interests of that party, the courts may interpret the power as not extending to the action proposed by the party in whom the power is vested or, alternatively, conclude that the powers are being exercised in a capricious or arbitrary manner or for an extraneous purpose, which is another way [sic] of saying the same thing. Thus, a vendor may not be allowed to exercise a contractual power where it would be unconscionable in the circumstances to do so ...

Hasluck J in *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [372] also seems to equate the two concepts:

The law does not prescribe a precise meaning of the term 'good faith' and it is probably no more than a prohibition on acting unconscionably. In that respect it is significant that s 51AC of the *Trade Practices Act* refers to the requirement for both parties to act in good faith in their dealings with each other.

⁸⁴ *Trade Practices Act 1974* (Cth) s 51AC(3)(k).

discretionary factors that do not define unconscionability but that may be taken into account in determining whether conduct was unconscionable.⁸⁵

IV THE MEANING OF GOOD FAITH

The foregoing analysis of existing legal duties demonstrates that '[t]he mistrust of Anglo-Saxon jurists for the general concept of good faith is equalled only by the imagination which they put towards multiplying particular concepts which lead to the same results.'⁸⁶ The attempt to define what good faith actually encompasses must nevertheless be made, with the awareness that 'general definitions of good faith either spiral into the Charybdis of vacuous generality or collide with the Scylla of restrictive specificity.'⁸⁷

Good faith 'has been described as a contextual standard'⁸⁸ and 'a generalisation of universal application',⁸⁹ with a standard of reasonableness having attracted the most support in recent Australian case law.⁹⁰ 'The difficulty with [a] contextual standard or a "generalisation of universal application" ... is [nevertheless] to identify the precise boundaries of this standard ... [which] has evaded the grasp of precise judicial statement.'⁹¹ Despite its long heritage in the US, the scope of the implied covenant of good faith remains elusive.

Uncertainty also reigns in Australia, with Peden commenting that 'most judgments concerning the implication of good faith or cooperation terms appear incoherent and contain little legal principle.'⁹² In *Council of the City of Sydney v Goldspar Australia Pty Ltd*, Gyles J described the 'variety of opinions' in both the authorities and the commentaries as 'bewildering' and noted that approaches vary from the 'cautious' to the 'adventurous'.⁹³ Jeannie Paterson argues that 'Australian case law has relied on synonyms or isolated examples to explain the duty, an approach which leaves much unanswered.'⁹⁴ Such an approach impacts negatively on legal certainty and does not help in setting a standard for franchisees and franchisors to aspire to in their dealings.

⁸⁵ *Trade Practices Act 1974* (Cth) s 51AC(3).

⁸⁶ Justice James Douglas, 'Exploring the Recent Uncertainty Surrounding the Implied Duty of Good Faith in Australian Contract Law: The Duty to Act Reasonably — Its Existence, Ambit and Operation' (Paper presented at the LexisNexis Contract Law Master Class, Brisbane, 24 August 2006) [40], quoting and translating Jacques-Henri Michel, 'Brève postface en guise d'introduction' in Centre de Recherches en Histoire du Droit et des Institutions, Facultés universitaires Saint-Louis Bruxelles, *La bonne foi* (1998) vii, x.

⁸⁷ Robert S Summers, "'Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code' (1968) 54 *Virginia Law Review* 195, 206.

⁸⁸ *Jobern Pty Ltd v BreakFree Resorts (Victoria) Pty Ltd* [2008] Aust Contract Reports ¶90-269, 90 211 (Gordon J) ('*Jobern*').

⁸⁹ *Hughes* (1997) 76 FCR 151, 193 (Finn J); see also at 191–2.

⁹⁰ See below Part IV(H).

⁹¹ *Jobern* [2008] Aust Contract Reports ¶90-269, 90 211 (Gordon J) (citations omitted).

⁹² Peden, *Good Faith in the Performance of Contracts*, above n 61, 120–1.

⁹³ (2006) 230 ALR 437, 498 ('*Goldspar*'); see also at 499.

⁹⁴ Jeannie Marie Paterson, 'Good Faith in Commercial Contracts? A Franchising Case Study' (2001) 29 *Australian Business Law Review* 270, 273.

A *Good Faith as the Antithesis of Bad Faith — The Excluder Approach*

Lord Scott in *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd* stated that '[u]nless the assured has acted in bad faith he cannot ... be in breach of a duty of good faith, utmost or otherwise.'⁹⁵ Arguably, the simplest way to think of what a duty of good faith might require is to think of it as an obligation to eschew bad faith — the approach articulated by Associate Professor Summers over forty years ago.⁹⁶ Summers sees good faith as a phrase which 'is best understood as an "excluder" — it is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith.'⁹⁷ His approach was characterised by the compilation of a list of bad faith behaviours, followed by a list of their opposites, in order to arrive at a more specific definition of good faith.⁹⁸ In *Jobern Pty Ltd v BreakFree Resorts (Victoria) Pty Ltd*, Gordon J provides an introduction to Summers' excluder approach, taking guidance from previous cases in setting out what bad faith might encompass:

Specific conduct has also been identified by various courts as constituting '*bad faith*' or a lack of '*good faith*' including:

- (1) acting arbitrarily, capriciously, unreasonably or recklessly ...
- (2) acting in a manner that is oppressive or unfair in its result by, for example, seeking to prevent the performance of the contract or to withhold its benefits ...
- (3) failing to have reasonable regards to the other party's interests ...
- (4) failing to act 'reasonably' in general.⁹⁹

Gordon J did not seem to place a great deal of emphasis on this characterisation of bad faith alone in the judgment.¹⁰⁰ Nevertheless, the repetition of the idea of reasonableness and related antonyms of arbitrariness, capriciousness, recklessness and unfairness (which themselves fail to paint a clear picture of what it is to act in bad faith), before ultimately washing out any meaning at all by impugning a failure to act reasonably in general, demonstrates a major weakness of the excluder approach: it does not provide enough guidance to courts or parties in determining whether conduct is or might be in breach of the implied obligation. In this way, the excluder approach fails to give a clear definition of what good or bad faith actually encompasses:

it seems tantamount to saying that the good faith duty is breached whenever a judge decides that it has been breached. This hardly advances the cause of intellectual inquiry and it provides absolutely no guide to the disposition of

⁹⁵ [2003] 1 AC 469, 515.

⁹⁶ Summers, above n 87, 199–207.

⁹⁷ Ibid 196 (citations omitted).

⁹⁸ See *ibid* 203.

⁹⁹ [2008] Aust Contract Reports ¶90-269, 90 212 (emphasis in original) (citations omitted).

¹⁰⁰ See *ibid* 90 213.

future cases, except to the extent that they may be on all fours with a decided case.¹⁰¹

While the idea of an excluder approach might appeal intuitively, it does not seem able of itself to guide either parties or courts in defining good faith behaviour with the degree of certainty required by contracting parties in commercial arrangements.¹⁰²

B *Good Faith as Honesty*

In attempting to positively define good faith, perhaps the most uncontroversial proposition in this controversial debate is that good faith at least requires parties to act honestly, and therefore that acting dishonestly connotes bad faith conduct. The idea of good faith as requiring honest standards of dealing has made cameo appearances in some of the cases dealing with good faith in the franchise context.¹⁰³ While good faith may require honesty, this is not such a groundbreaking or instructive requirement for, as Einstein J states in *Aiton Australia Pty Ltd v Transfield Pty Ltd*, 'parties are subject to a universal duty to act honestly' in any case.¹⁰⁴ This supports the argument of Bergin J in *Insight Oceania* that the inclusion of a requirement to act honestly as part of a duty of good faith would be 'otiose'.¹⁰⁵ The major problem with a standard of 'honesty' is not only the evidentiary challenge to a franchisee of proving dishonesty but also that it will not catch many forms of bad faith which are characterised by honest behaviour yet which nevertheless impact negatively and significantly upon the legitimate interests or expectations of the other.

C *Good Faith as Fairness*

If the idea of acting honestly adds little to a definition of good faith, recurring statements that good faith requires parties to act 'fairly' towards one another, 'not only in relation to the performance of a contractual obligation, but also in the exercise of a power conferred by the contract',¹⁰⁶ pose even greater challenges.

¹⁰¹ Michael G Bridge, 'Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?' (1984) 9 *Canadian Business Law Journal* 385, 398.

¹⁰² Justice Robert McDougall, 'The Implied Duty of Good Faith in Australian Contract Law' (2006) 108 *Australian Construction Law Newsletter* 28, 33, raises another weakness — that the bad faith approach effectively requires intention:

It is plain that a failure to cooperate in achieving the contractual aim may be caused by oversight rather than intent; but only in the latter case would bad faith be arguable. Bad faith is but one of the causes of want of good faith. And bad faith may impeach the exercise of a contractual power that is not conditioned by, or subject to, an obligation of good faith in connexion with its exercise.

¹⁰³ An example of this comes from *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (Unreported, Rolfe J, 5 November 1999) [686] ('*Burger King (Trial)*'), where Rolfe J states that, in acting dishonestly by failing to advise its master franchisee (Hungry Jack's) that a high ranking manager was breaching his fiduciary duties to the company, the franchisor (Burger King) had 'breached the implied terms of reasonableness and good faith'.

¹⁰⁴ (1999) 153 FLR 236, 262 (emphasis added).

¹⁰⁵ [2008] NSWSC 710 (Unreported, Bergin J, 23 July 2008) [178].

¹⁰⁶ *Garry Rogers* [1999] ATPR ¶41-703, 43 014 (Finkelstein J).

While an intuitively attractive idea, fairness is too abstract an ideal to which to subject contractual parties in the real world. This is probably why it has not received much support beyond its being tacked on to the end of sentences where good faith is mentioned in various judgments.¹⁰⁷ Indeed, the application of an abstract notion of fairness in the face of the exercise of hard, explicit contractual rights which might seem *unfair* in certain circumstances, yet which were in terms agreed to at formation with the intention of allowing parties to act in self-interested ways and to plan future action based on potential future options, poses obvious difficulties. What a franchisor may see as the fair exercise of contractual terms designed to protect its interests, a franchisee might perceive as completely unfair to the point of being unconscionable. Bingham LJ in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* states that acting in good faith

does not simply mean that [parties] should not deceive each other ... [I]ts effect is perhaps most aptly conveyed ... as 'playing fair', 'coming clean' or 'putting one's cards face upwards on the table'. *It is in essence a principle of fair and open dealing.*¹⁰⁸

While a higher standard of conduct might attend the successful execution of relational franchising contracts, defining this standard by reference to a concept such as fairness would fail to adequately provide guidance on what might be required of parties in any particular circumstance, largely because of the subjective nature of the concept. This would severely impact on the certainty necessary in dynamic business relationships where fortunes and futures hang in the balance. Indeed, it does not appear necessary to subject contractual parties to a standard so vague in their commercial dealings in order to achieve through good faith what its proponents would like it to do.

While the idea of fairness may go beyond a general duty of honesty in requiring the fair exercise of contractual terms, no guidance on what constitutes 'fair' has been given in the case law beyond not acting for ulterior motives or extraneous purposes. Professor Michael Bridge's comment that good faith appears to be 'a concept which means different things to different people in different moods at different times and in different places'¹⁰⁹ is particularly compelling in relation to a concept of good faith based simply on fairness.

D *Good Faith as the Absence of Opportunistic Conduct and Extraneous or Ulterior Purposes*

A more specific formulation which involves application of the ideas of honesty and fairness in relation to the exercise of rights under contractual terms is the idea that good faith precludes contractual parties from acting opportunistically or

¹⁰⁷ See, eg, *ibid*; *Bamco Villa Pty Ltd v Montedeen Pty Ltd* [2001] VSC 192 (Unreported, Mandie J, 20 June 2001) [190]; *Far Horizons* [2000] VSC 310 (Unreported, Byrne J, 18 August 2000) [130]; *Renard* (1992) 26 NSWLR 234, 268 (Priestley JA).

¹⁰⁸ [1989] 1 QB 433, 439 (emphasis added), quoted in Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 291.

¹⁰⁹ Bridge, above n 101, 407.

using contractual terms for purposes antithetical to the contract that are calculated to extract value from the other contractual party. The problem with the use of contractual powers for reasons other than those envisioned at formation is that such behaviour would negatively impact on the certainty of the arrangement agreed upon and potentially affect the rights bargained for by the parties. This echoes the 'foregone opportunities' approach of Steven Burton,¹¹⁰ whereby one party acts to reclaim opportunities surrendered at contract formation.¹¹¹ This was a feature of the *Burger King* litigation, where contractual powers to grant operational approval for new stores and to terminate the franchise agreement were used for purposes foreign to those envisioned at formation.¹¹² The actions were carried out in the context of Burger King's 'wishing to regain control of the Australian market' and its 'embark[ing] on a deliberate strategy to win back that market, which it acknowledged it had lost through its own neglect', in pursuit of which it employed 'a policy of confining, disrupting and thwarting the activities of [Hungry Jack's] to the extent that it was within its interests to do so.'¹¹³

A clear explanation of what would constitute extraneous purposes or intentions in the franchise context is given by Dodds-Streton J in *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd*:

in my opinion an implied obligation of good faith would preclude the franchisor from exercising, or threatening to exercise, its literally unqualified power under the franchise agreement ... in order to secure [the franchisees'] premature determination, negate their extended term and expropriate [their] interests at an undervalue.¹¹⁴

These concepts appear to aid in the analysis of conduct in cases involving a duty of good faith and may cover instances where contractual terms might have been abused as well as where contracts are silent on particular issues. They nevertheless closely resemble the doctrine of non-derogation from grant outlined above.¹¹⁵ Actions motivated by ulterior purposes or by a desire to regain foregone opportunities may be regarded more helpfully as a derogation from the grant originally made.

E Good Faith as Legitimate Interests

In considering what good faith means in the franchise context, 'it becomes necessary to enquire about the extent to which selflessness is required.'¹¹⁶ According to most decisions, parties are not required to eschew their own self-interest or proprietary rights,¹¹⁷ so long as the pursuit of any of these interests

¹¹⁰ Steven J Burton, 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1980) 94 *Harvard Law Review* 369, 369.

¹¹¹ See *ibid* 373, 377–8.

¹¹² *Burger King (Trial)* [1999] NSWSC 1029 (Unreported, Rolfe J, 5 November 1999) [508]–[554].

¹¹³ *Ibid* [18].

¹¹⁴ [2006] VSC 223 (Unreported, Dodds-Streton J, 21 June 2006) [212].

¹¹⁵ See above Part III(B).

¹¹⁶ *Overlook* [2002] Aust Contract Reports ¶90-143, 91 970 (Barrett J).

¹¹⁷ See, eg, *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [353].

does not interfere with that party's duty to cooperate to achieve the aims of the contract¹¹⁸ and does not interfere 'unreasonabl[y]'¹¹⁹ with the enjoyment by the other party of benefits conferred by the contract (namely, in a way which renders them 'nugatory, worthless or, perhaps, ... seriously undermined').¹²⁰ This does not equate to a fiduciary duty to prefer the other party's interests to one's own. The cases have insisted that good faith requires a party 'to recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms', although the interests of the other party are not paramount.¹²¹ If this be the case, what constitutes the legitimate interests to which parties are to have 'due regard'? Could a legitimate interests approach work to allow the recognition of 'interests' not explicitly part of the written contract or to impose any restraint on the use of contractual powers which does not otherwise offend that contract? Another problem is that consideration of the other party's interests has been explained as requiring 'deal[ing] promptly, honestly, fairly and reasonably' with that party¹²² — concepts which are, in themselves, unclear.

The proposition that good faith 'would not operate so as to restrict actions designed to promote the legitimate interests of [a] party'¹²³ is routinely expounded in the good faith case law and commentary. It gives rise to at least two distinct issues: whether 'legitimate interests' refers to strict contractual interests or wider commercial interests, and whether the standard would allow or deny a party the opportunity to pursue its own legitimate interests beyond a point where they result in the destruction or undermining of the other party's business interests.

In *Far Horizons Pty Ltd v McDonald's Australia Ltd* ('*Far Horizons*'), Byrne J found that McDonald's refusal to grant an existing franchisee the licence for new stores to be opened in the surrounding area was driven not by McDonald's desire to punish the principal or the franchisee but by McDonald's own legitimate interests.¹²⁴ McDonald's could demonstrate commercial reasons for its conduct in choosing to offer new stores to new franchisees and thus was held not to have made the decisions in bad faith.¹²⁵ Byrne J nevertheless acknowledged that there may be limits on the extent to which franchisors can adversely affect a franchisee's business and left 'for another day' extreme cases where the

¹¹⁸ *Ibid* [351].

¹¹⁹ *Overlook* [2002] Aust Contract Reports ¶90-143, 91 970 (Barrett J).

¹²⁰ *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 450 (McHugh and Gummow JJ) ('*Byrne*'), quoted in *ibid*.

¹²¹ *Overlook* [2002] Aust Contract Reports ¶90-143, 91 970 (Barrett J). See, eg, *Mason v Freedman* [1958] SCR 483, cited in *Shelanu* (2003) 64 OR (3d) 533, 556 (Weiler JA for Weiler, Austin and Laskin JJA).

¹²² *Shelanu* (2003) 64 OR (3d) 533, 540 (Weiler JA for Weiler, Austin and Laskin JJA).

¹²³ *Garry Rogers* [1999] ATPR ¶41-703, 43 014 (Finkelstein J).

¹²⁴ [2000] VSC 310 (Unreported, Byrne J, 18 August 2000) [117].

¹²⁵ *Ibid* [130].

franchisor acted so as to ‘effectively destroy’ the business for which the franchisee had bargained.¹²⁶

Far Horizons can be contrasted with the decision in *Laurelmount Pty Ltd v Stockdale & Leggo (Queensland) Pty Ltd*, where Dutney J agreed with the trial judge that there was a distinction between the conscious yet incidental, as opposed to the willingly intentional, destruction of a franchisee’s business.¹²⁷ With regard to the former situation, it was not thought necessary to imply a term to restrain the franchisor from acting in a way that had this result, while in the latter situation a court may imply such a term:

If the [franchisor’s] commercial interest would be benefited by a dealing which incidentally may have the effect of damaging or destroying the business of a franchisee, I do not think it is necessary to give business efficacy to the franchise agreement to imply a term preventing the franchisor from so conducting itself. That is different from the implication of a term that the first defendant or second defendant not conduct itself with the object of damaging or destroying the business of the [franchisee’s] Maroochydhore office. Such a term may be necessary to give business efficacy to a franchise agreement.¹²⁸

Dutney J seems to accord little weight to the fact that he was dealing with a franchised business and that both parties’ interests were held within each other’s control; each party might therefore expect that they would consider the other’s interests and possibly avoid harming them rather than engaging in conduct which would be damaging to the business. On the other hand, Dutney J is probably just stating the tougher side of the usual rhetoric that parties to a franchise contract need only have ‘due regard’ for the other party’s legitimate interests without needing to sacrifice their own. As soon as one party can say, ‘I have considered your legitimate interests, yet I choose to engage in a particular course of conduct detrimental to them, which I have a right to do as per this contract’, good faith appears paralysed and thus unable to effect the levelling of the field of economic action on which franchise agreements operate.

The Court in *Burger King (Appeal)* also took this approach, stating that a requirement that powers be exercised in good faith would not restrain Burger King from pursuing its own legitimate interests, so long as it did not do so for a purpose extraneous to the contract.¹²⁹ This idea is expressed more precisely, and without the baggage of extraneous purposes, in *Overlook* by Barrett J in the proposition that good faith does not require subordination of one’s own interests

so long as pursuit of those interests does not entail unreasonable interference with the enjoyment of a benefit conferred by the express contractual terms so

¹²⁶ See *ibid*. See below n 182 and accompanying text.

¹²⁷ [2001] QCA 212 (Unreported, McPherson, Williams JJA and Dutney J, 5 June 2001) [43]–[44].

¹²⁸ *Ibid* [43] (Dutney J), quoting *Laurelmount Pty Ltd v Stockdale & Leggo (Queensland) Pty Ltd* (Unreported, Queensland District Court, Dodds DCJ, 2 May 2000) [31].

¹²⁹ (2001) 69 NSWLR 558, 573 (Sheller, Beazley and Stein JJA).

that the enjoyment becomes (or could become) ... 'nugatory, worthless or, perhaps, [be] seriously undermined'.¹³⁰

On Barrett J's analysis, the sources to be looked to in order to determine whether unreasonable interference has occurred are the 'express contractual terms' and the benefits conferred by them. The problem is that relational contracts, of which franchising contracts are a species, are necessarily incomplete and beset by the realities of standard form contracts and power imbalance. If the legitimate interests approach is set to work solely on contractual terms, 'courts [would] fail to protect fully one half of the interests necessary to support the franchise relationship'.¹³¹ While Barrett J does look at the overall character of the agreement, in order to gain an 'appreciation of the prohibitory or negative spirit with which the contracts are infused'¹³² and therefore protect expectations of enjoyment of the contractual terms from being undermined, this approach demonstrates the reality of Hadfield's criticism: that legitimate interests is too high a threshold for the effective operation of good faith in order to protect both parties to the franchise contract.¹³³ This problem is also mirrored in the guidance that good faith may preclude actions that would render rights nugatory, worthless, or seriously undermined — there remains a wide margin for error on the part of the franchisor before any actions have this effect.¹³⁴

Indeed, how prohibitory could the character of a standard form contract weighted in the franchisor's interest possibly be on actions engaged in by the stronger party? Standard form contracts are designed to afford maximum freedom to the franchisor, meaning that there is not much for good faith to operate on for the benefit of a franchisee if the approach to legitimate interests outlined above is taken. This approach would set too high a threshold for franchisees to benefit from the operation of a good faith requirement. It would allow any rational business decision made in the franchisor's interests to trump the idea of good faith as existing to level the playing field on which the relationship takes shape. It would lead to conclusions such as that of Barrett J in *Overlook*, describing a business decision as, 'on its face, ... quite a reasonable commercial proposition, at least in abstract terms'¹³⁵ — a conclusion which in effect could be drawn of nearly any business conduct unless it had no reason whatsoever and was truly arbitrary.

As such, a legitimate interests approach centred on express contractual terms appears to protect the rights of the franchisor, yet would do little to protect the investment and interests of franchisees who enter a standard form contract with only the expectation (for the contract itself rarely would make requirements, in

¹³⁰ [2002] Aust Contract Reports ¶90-143, 91 970, quoting *Byrne* (1995) 185 CLR 410, 450 (McHugh and Gummow JJ).

¹³¹ Hadfield, above n 44, 983.

¹³² *Overlook* [2002] Aust Contract Reports ¶90-143, 91 971.

¹³³ See Hadfield, above n 44, 943.

¹³⁴ *Ibid.*

¹³⁵ [2002] Aust Contract Reports ¶90-143, 91 972.

words, of the franchisor) that the franchisor remain accountable to the relationship supposedly created for their mutual benefit. This approach seems to land us back at the beginning — parties must cooperate to fulfil contractual ends. It is difficult to see what an implied term of good faith adds if independent duties of cooperation and non-derogation from grant cover the same ground.

This illustrates the fact that all the franchisee really has to hold onto in the absence of express contractual terms in a relational standard form contract is the expectations created by the franchisor, and the relationship as such, as opposed to the franchisor's 'hard' business interests specified in the contract. The business interests approach assists the franchisor by focusing on contractually expressed interests rather than helping remedy the situation that allows for a standard form contract heavily weighted against the franchisee to represent the entirety of the relationship. Framed in this way, a requirement of good faith might find it difficult to level the playing field such that both parties' continuing interests in the relationship can be recognised, not solely the franchisor's business imperatives. This would amount to treating the franchisee as the franchisor's risk-taker, a position no rational person would accept without adequate return on their investment for their risk.

This is why, as Hadfield argues, there should be due consideration not only for the state of affairs apparent when the franchisee entered the contract but also for the continuing relationship and the expectations engendered therein.¹³⁶ This suggests another approach to good faith, which is to consider the 'reasonable expectations' of parties to a contract.

F *Good Faith as Regard for Reasonable Expectations*

The limitations on the scope of the legitimate interests test outlined above in achieving what is desired in a standard of good faith may be ameliorated with support from a test of reasonable expectations. As noted by Summers, '[i]n most cases the party acting in bad faith frustrates the justified expectations of another ... [and] the ways in which he may do this are numerous and radically diverse.'¹³⁷ Possibly for the latter reason, the reasonable expectations approach has received little judicial attention, although it appears to underlie the approaches outlined above. The reasonable expectations approach was referred to by Barrett J in *Overlook* when his Honour outlined the process of maintaining the integrity of a contract in these circumstances. Achieving this would require

an appreciation of the prohibitory or negative spirit with which the contracts are infused in order to protect the parties' legitimate expectations of enjoyment

¹³⁶ See Hadfield, above n 44, 985–6.

¹³⁷ At the conclusion of his seminal paper, Summers, above n 87, 263 (citations omitted), posed the rhetorical question: 'Can you say what [good faith] is?' He answered it thus:

In most cases the party acting in bad faith frustrates the justified expectations of another. As I have tried to show, the ways in which he may do this are numerous and radically diverse. Moreover, whether an aggrieved party's expectations are justified must inevitably vary with attendant circumstances. For these reasons it is not fruitful to try to generalize further ... Besides, any general definition of good faith, if not vacuous, is sure to be unduly restrictive, especially if cast in statutory form.

from being rendered nugatory or worthless or seriously undermined ... [T]he court must proceed to decide whether the conduct of Foxtel was, in the light of [these matters], such as to cause those legitimate expectations of enjoyment to be affected in any of the ways mentioned.¹³⁸

Under a reasonable expectations approach — which is arguably wider than the legitimate interests approach — courts may be able to take a more balanced approach to franchising disputes by allowing to franchisees, who might have had their legitimate expectations of contractual performance frustrated and are not able to make a case in situations where they do not possess formal ‘legitimate interests’ (as specified in a written contract), a valid avenue for redress they otherwise would not have had.

The application of a reasonable expectations test might require a court to take account of business norms structuring the relationship. Sir Anthony Mason has commented that:

The implied obligation does no more than spell out what, on the true construction of the contract, is the effect of promises and undertakings entered into by the party. In reaching that construction, it will be relevant to take account of the legitimate or reasonable expectations of the parties when they make the contract.¹³⁹

Such a formulation supports a consideration of the expectations of each party at the time of formation and entry into a contract, but it mentions nothing of the idea that expectations can change and original contractual terms can be overlapping and thus be superseded by new norms and expectations. An example of their having done so comes from the *Burger King* litigation, where both parties were engaged in tripartite negotiations with Shell to begin operations at Shell service stations.¹⁴⁰ With the intention to proceed on a test site basis, ‘there was a clear expectation by the parties that the test site arrangements were being pursued in the context of a potentially longer term relationship in which, at the least, the parties would be joint venturers.’¹⁴¹ Hungry Jack’s legitimate expectations led it to act in ways it otherwise would not have done and thus to suffer loss when Burger King frustrated these expectations.

An important consideration in the use of the reasonable expectations approach, as noted by Joel Iglesias, is that ‘what a party can reasonably expect must be determined not on subjective hopes, but on economic reality.’¹⁴² A reasonable expectations approach seems to be broad enough to include reference to norms

¹³⁸ *Overlook* [2002] Aust Contract Reports ¶90-143, 91 971. Overlook was a provider of television content to Foxtel, which Foxtel onsold to customers as add-on channels: at 91 957, 91 959. Without warning, Foxtel reduced by approximately half the amount it charged for the add-on channels provided by Overlook, which had the effect of reducing Overlook’s returns: at 91 959. Overlook argued that this constituted a breach of an implied obligation of good faith by Foxtel: at 91 972.

¹³⁹ A F Mason, ‘Contract, Good Faith and Equitable Standards in Fair Dealing’ (2000) 116 *Law Quarterly Review* 66, 75.

¹⁴⁰ *Burger King (Trial)* [1999] NSWSC 1029 (Unreported, Rolfe J, 5 November 1999) [275]–[346].

¹⁴¹ *Ibid* [292].

¹⁴² Joel Iglesias, ‘Applying the Implied Covenant of Good Faith and Fair Dealing to Franchises’ (2004) 40 *Houston Law Review* 1423, 1450 (citations omitted).

of the relationship as designated by the contract and the understanding surrounding it — arguably the very point of good faith being applied in franchise cases. This seems to be a barely disguised consideration in various cases where courts seem to be embracing a ‘relational approach albeit not in the language of it.’¹⁴³ If good faith were restricted to working on express contractual terms, as in the approach in *Overlook* described above, the norms underlying the relationship would be defeated by express terms every time, allowing a franchisor to do as it wished regardless of a franchisee’s reasonable expectations. It appears that the knights of good faith wish the concept to have the ability to question whether the franchisor has considered the rights and legitimate expectations of franchisees and the franchise relationship in its decision-making.

At the very least, good faith as reasonable expectations would need to be able to work on the underlying understanding between the parties at formation and should be open to evidence other than the bare face of the contract. The franchisor’s sales pitch and promotional material may thus constitute evidence of a reasonable expectation in the circumstances (in the absence of conflicting contractual terms) and may serve to assist the court in getting into the frame of mind of a franchisee who was contemplating the acquisition of a franchise, in analysing what legitimate expectations a franchisee would have in the circumstances and whether these interests had been given due regard. Such an approach would overcome any difficulties with the legitimate interests approach as applied by Barrett J.

While it may appear to be broad-brush, the reasonable expectations approach might just fit the necessary requirements for a standard of good faith, with Bridge going so far as to state that

[t]his reference to justified expectations ... is much more satisfactory than good faith as a guide to the resolution of practical problems. It is particularly apt in explaining a number of the movements that have taken place in recent years in a dynamic Anglo-Canadian law of contract.¹⁴⁴

It should be said, however, that the idea of reasonable expectations bears an uncanny resemblance to the established doctrine of non-derogation from grant and the reasonable expectations one party might hold in relation to a particular grant.

G *Good Faith as Community Standards*

Generally considered to be the initial foray into the ‘community standards’ wilderness were Priestley JA’s comments in *Renard*:

As the words used in the sequence of statutes show, the ideas of unconscionability, unfairness, and lack of good faith have a great deal in common. The result is that people generally, including judges and other lawyers, from all strands of the community, have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all con-

¹⁴³ Terry, above n 44, 299.

¹⁴⁴ Bridge, above n 101, 400.

tracts of a duty upon the parties of good faith and fair dealing in its performance. In my view this is in these days the expected standard, and anything less is contrary to prevailing community expectations.¹⁴⁵

Priestley JA expressly excluded these comments from his *ratio decidendi* in that case;¹⁴⁶ they thus formed obiter statements on good faith generally. To say, however, that Priestley JA 'adopted ... an approach' 'whereby the measure of good faith performance is based on standards imposed by a "judging community" independent of the contractual parties'¹⁴⁷ is incorrect. On a careful reading, Priestley JA is not saying that community standards constitute or even inform the test for good faith. He merely says that enforcing good faith (whatever the meaning attached to it by the court) reflects community standards and expectations for the resolution of matters by the courts. Indeed, no subsequent case has attempted to apply this vague idea. As noted by Bill Dixon:

In the same manner that Finn J has expressly disavowed the invocation of 'community standards' in the good faith debate, perhaps his judicial brethren have also recognised the perilous nature of this territory and have preferred to base their judicial responses on the far less contentious, and longstanding, basis of reasonable expectations.¹⁴⁸

H Good Faith as Reasonableness

Over a century ago, Bowen LJ commented on the concept of reasonable standards for commercial contracting in *The Mogul Steamship Co Ltd v McGregor, Gow & Co*:

I myself should deem it to be a misfortune if we were to attempt to ... adopt some standard of judicial 'reasonableness' ... to which commercial adventurers, otherwise innocent, were bound to conform.¹⁴⁹

Despite a renaissance in some cases, the caution of Bowen LJ retains much of its force. In *Garry Rogers* — a case involving the use of a termination clause by a franchisor — Finkelstein J stated that, 'provided the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied.'¹⁵⁰ Although this might be overstating the content of a good faith obligation operative in business relationships, this has provided a platform for exploration of the content of such an obligation in subsequent cases.

In *Far Horizons*, Byrne J felt bound by the authorities following *Renard* and stated that a 'good faith' obligation would oblige 'each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not

¹⁴⁵ (1992) 26 NSWLR 234, 268. See generally Tyrone M Carlin, 'The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25 *University of New South Wales Law Journal* 99.

¹⁴⁶ *Renard* (1992) 26 NSWLR 234, 271.

¹⁴⁷ Dixon, 'Can the Common Law Obligation of Good Faith Be Contractually Excluded?', above n 6, 113 (citations omitted).

¹⁴⁸ *Ibid* 120 (citations omitted).

¹⁴⁹ (1889) 23 QBD 598, 620.

¹⁵⁰ [1999] ATPR ¶41-703, 43 014.

capriciously or for some extraneous purpose.¹⁵¹ Reasonable exercise of contractual powers would thus preclude impulsive actions which lack a rational basis altogether, as well as those which may be all 'too rational' to the extent they were calculated to extract a benefit extraneous to the contract between the parties. The equating of good faith with reasonableness has, not surprisingly, been criticised as being 'more confusing than instructive.'¹⁵² As Peden has observed:

There is no precise meaning given, but rather a repetition of well-worn phrases and quotes, without explanation of how and why they fit together. There is, furthermore, no explanation of why 'reasonableness' is a justified inclusion in the meaning of good faith, and why it is considered identical to 'good faith'.¹⁵³

This can be said of most cases in which a consideration of 'reasonableness' appears. A further problem could be that which Priestley JA discussed in *Renard* regarding the commonality of meanings between the terms 'good faith' and 'reasonableness':

in ordinary English usage there has been constant association between the words fair and reasonable. Similarly, there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability.¹⁵⁴

While the NSW Court of Appeal in *Burger King (Appeal)* also emphasised that 'the Australian cases make no distinction of substance between the implied term of reasonableness and that of good faith',¹⁵⁵ neither the Court of Appeal nor subsequent decisions have developed the case for good faith as reasonableness. While there may be an overlap in their content, it has been argued that '[t]he interrelationship of and difference between good faith and reasonableness is subtle but of great importance. A requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith.'¹⁵⁶ Indeed, notwithstanding these linguistic issues, to require parties to a commercial contract to temper their conduct by reference to 'reasonable' standards of conduct has implications for the fundamental need for certainty in franchise contracting, despite its relational nature.

The principle recently referred to by Kirby J in *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd* ('*Sanpine*') — 'that parties should ordinarily fulfil their contractual obligations'¹⁵⁷ — is of course not sacrosanct, as common law and legislative developments in relation to standards of behaviour in commercial contracting demonstrate. A further encroachment on this principle by way of a bare standard of 'reasonableness' is unlikely to attract as much support

¹⁵¹ *Far Horizons* [2000] VSC 310 (Unreported, Byrne J, 18 August 2000) [120].

¹⁵² Peden, *Good Faith in the Performance of Contracts*, above n 61, 176.

¹⁵³ *Ibid.*

¹⁵⁴ (1992) 26 NSWLR 234, 265.

¹⁵⁵ (2001) 69 NSWLR 558, 570 (Sheller, Beazley and Stein JJA).

¹⁵⁶ Jane Stapleton, 'Good Faith in Private Law' (1999) 52 *Current Legal Problems* 1, 8.

¹⁵⁷ (2007) 233 CLR 115, 148.

as one based on 'reasonable commercial standards'. The latter approach has been taken in Canada in the four provinces which have enacted franchise-specific laws. Each impose on both franchisor and franchisee 'a duty of fair dealing in the performance and enforcement of the franchise agreement.'¹⁵⁸ In Ontario, Prince Edward Island and New Brunswick — and under the *Uniform Franchises Act* (a model law prepared by the Uniform Law Conference of Canada in 2005)¹⁵⁹ — the duty of 'fair dealing' includes 'the duty to act in good faith and in accordance with reasonable commercial standards'.¹⁶⁰ In *1323257 Ontario Ltd v Hyundai Auto Canada Corp*, the Ontario Superior Court of Justice considered, in interlocutory proceedings, an express good faith clause in the National Automobile Dealer Arbitration Program ('NADAP') *Rules for Dispute Resolution*.¹⁶¹ This clause, which required parties to a dealer agreement to interpret, apply, perform and enforce agreements, and exercise unilateral or discretionary rights in good faith, was defined as follows:

'Good Faith' — means the observance of reasonable commercial standards by balancing, where, and to the extent relevant, the interests of the Manufacturer, the Dealer, the collective interests of the Manufacturer and all of its dealers, and the interest of the customers of all of its dealers, and by recognizing the competitive nature of the automotive industry.¹⁶²

The Court held, with little discussion, that the franchisor's non-disclosure of material facts gave rise to a serious question to be tried.¹⁶³ A starting point for consideration of a definition of good faith based on reasonable commercial standards may be the NADAP definition, with the references to 'manufacturer' and 'dealer' replaced by 'franchisor' and 'franchisee', and the reference to the 'automotive industry' replaced by reference to 'the industry sector in which the franchise operates'.

V LIMITATIONS ON A GOOD FAITH OBLIGATION

Apart from limitations inherent in the as yet undefined scope of the implied term, there exist three potential limitations on the capacity of a good faith obligation to operate, as some argue it should, as a broad mechanism for promoting ethical conduct in business:

¹⁵⁸ This is the wording of the New Brunswick statute: *Franchises Act*, SNB 2007, c F-23.5, s 3(1). The Prince Edward Island statute is almost identical: see *Franchises Act*, RSPEI 1988, c F-14.1, s 3(1). The Alberta and Ontario statutes are similarly worded: see *Franchises Act*, RSA 2000, c F-23, s 7; *Arthur Wishart Act (Franchise Disclosure)*, SO 2000, c 3, s 3(1).

¹⁵⁹ See Uniform Law Conference of Canada, *Uniform Franchises Act* (2005) ss 3(1), (3) <http://www.ulcc.ca/en/us/uniform_franchises_act_en.pdf>.

¹⁶⁰ *Franchises Act*, SNB 2007, c F-23.5, s 3(3)(a); *Arthur Wishart Act (Franchise Disclosure)*, SO 2000, c 3, s 3(3); *Franchises Act*, RSPEI 1988, c F-14.1, s 3(3). See generally Shannon Kathleen O'Byrne, 'Breach of Good Faith in Performance of the Franchise Contract: Punitive Damages and Damages for Intangibles' (2004) 83 *Canadian Bar Review* 431, 432–5.

¹⁶¹ (2009) 55 BLR (4th) 265, [55], [78] (D M Brown J) ('*Hyundai*').

¹⁶² NADAP, *Rules for Dispute Resolution* (2006) para 1(m) <<http://www.aiamc.com/files/NADAP%20Renewal%202006%20-%20Rules%20-%20EN.pdf>>. The Court quotes an earlier version of these rules, but the definition of 'good faith' has not changed: see *ibid* [78].

¹⁶³ *Hyundai* (2009) 55 BLR (4th) 265, [80] (D M Brown J).

- Can good faith impose obligations inconsistent with other terms of the agreement?
- Can good faith be excluded?
- Can good faith be an independent source of obligations or must it relate to a violation in bad faith of an express term of the agreement?

These will now be examined in turn.

A Good Faith and Inconsistent Contractual Provisions

The Australian and US authorities overwhelmingly support the proposition that any implied term of good faith must be consistent with the explicit terms of the contract. The proposition of Justice Robert McDougall, writing extra-judicially, that the courts cannot imply a duty of good faith 'inconsistently with the express language of the contract, or necessary implications therefrom'¹⁶⁴ has wide support. In *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* [No 6] ('*Ingot Capital Investments* [No 6]'), McDougall J stated:

it is plain that no duty of good faith can be implied where the duty ... is inconsistent with an express term of the contract ... Further, even if there is no direct conflict between the term sought to be implied and any express term of the contract, the express terms of the contract as a whole may negate the implication ...¹⁶⁵

In *Insight Oceania*, Bergin J expressed this clearly: she stated that the duty 'does not rise above the promises made by the parties to the contract'¹⁶⁶ and, quoting *Alcatel Australia Ltd v Scarcella*, that it 'cannot over-ride the express provisions of the contract'.¹⁶⁷

While the determination of whether there is, in Bergin J's words, an express contractual term which will trump the implied obligations may be relatively straightforward, the exercise becomes much more complex if good faith can be

¹⁶⁴ McDougall, above n 102, 36. In *Burger King (Appeal)* (2001) 69 NSWLR 558, 570 (Sheller, Beazley and Stein JJA), quoting *Metropolitan Life Insurance Co v RJR Nabisco Inc*, 716 F Supp 1504, 1517 (Walker J) (citations omitted) (SDNY, 1989), the NSW Court of Appeal accepted that as 'was explained in *Metropolitan Life* ... "the implied covenant will only aid and further the explicit terms of the agreement and will never impose an obligation 'which would be inconsistent with other terms of the contractual relationship'."'. Similarly, in *Central Exchange Ltd v Anaconda Nickel Ltd* (2002) 26 WAR 33, 52 ('*Central Exchange*'), quoting *Kham & Nate's Shoes No 2 Inc v First Bank of Whiting*, 908 F 2d 1351, 1357 (7th Cir, 1990) (Easterbrook J for Wood, Easterbrook and Eschbach JJ), Steytler J of the Full Court of the Supreme Court of Western Australia accepted that the 'principles of good faith "do not block [the] use of terms that actually appear in the contract"'. See also *Central Exchange* (2002) 26 WAR 33, 36 (Malcom CJ), 39 (Wallwork J).

¹⁶⁵ (2007) 63 ACSR 1, 148–9, citing *Vodafone* [2004] NSWCA 15 (Unreported, Sheller, Giles and Ipp JJA, 20 February 2004) [194]–[207] (Giles JA). There, at [194], Giles JA stated: 'It is sufficient to ask whether an implied obligation of good faith and reasonableness with the content upon which the judge rested his findings of breach is inconsistent with the terms of the contract'.

¹⁶⁶ [2008] NSWSC 710 (Unreported, Bergin J, 23 July 2008) [162].

¹⁶⁷ *Ibid*, quoting *Alcatel* (1998) 44 NSWLR 349, 368 (Sheller JA). The comments were made in relation to the duty to cooperate but are applicable to good faith in this context.

excluded by necessary implication. This was suggested by Greenwood J in *Luce Optical Pty Ltd v Budget Specs (Franchising) Pty Ltd*:

good faith is an incident of every commercial contract unless the duty is excluded expressly or by necessary implication and ... the duty operates as a fetter upon the exercise of discretions and powers conferred by the contract ...¹⁶⁸

B Excluding Good Faith

It follows from the above that the implied obligation of good faith can be excluded by an appropriate exclusion clause — the ‘express contractual provision will trump an implied contractual provision.’¹⁶⁹ Whether ‘entire agreement’ clauses have the effect of excluding the implied obligation of good faith is less certain.¹⁷⁰

In *Ingot Capital Investments [No 6]*, McDougall J left open the question as to whether the express terms of the contract as a whole may negate the implication of a duty of good faith.¹⁷¹ In *NT Power Generation Pty Ltd v Power and Water Authority*, Mansfield J in the Federal Court held that an appropriately drafted entire agreement clause would be construed as inconsistent with and would therefore exclude the implication of terms into an agreement,¹⁷² including an implied condition of good faith.¹⁷³ However, doubt as to this view was expressed by Finn J in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*, referring to a difficulty of ‘distinctly doctrinal character’:

Is the duty one that can be excluded by agreement? On one view, reflected in civilian legal systems and § 1-102(3) of the *Uniform Commercial Code*, the very rationale of the duty in contract law precludes its exclusion. But as a matter of legal doctrine in this country it must be accepted that, as an implied term, it is capable of being excluded by express or by inconsistent provision — although it is, perhaps, difficult to envisage an express provision authorising dishonesty.¹⁷⁴

His Honour considered that, under Australian law, an entire agreement clause does not preclude implications ad hoc and found ‘arresting the suggestion that an entire agreement clause is of itself sufficient to constitute an “express exclusion”

¹⁶⁸ [2005] FCA 1486 (Unreported, Greenwood J, 20 October 2005) [59], citing *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] Aust Contract Reports ¶90-213, 88 498 (*‘Pacific Brands’*), where Finkelstein J, according to Greenwood J, ‘gathered together a range of cases and articles reflecting American jurisprudence’ to support this proposition.

¹⁶⁹ Dixon, ‘Can the Common Law Obligation of Good Faith Be Contractually Excluded?’, above n 6, 115 (citations omitted).

¹⁷⁰ *Hart v MacDonald* (1910) 10 CLR 417 is authority for the proposition that a whole of agreement clause will not exclude terms implied by law.

¹⁷¹ See (2007) 63 ACSR 1, 148–9.

¹⁷² (2001) 184 ALR 481, 571 (*‘NT Power’*).

¹⁷³ See *ibid* 568, 570–1, 574–5.

¹⁷⁴ (2003) 128 FCR 1, 209.

of an implied duty of good faith and fair dealing where that implication would otherwise have been made by law.¹⁷⁵

If in accordance with the recommendation of the *Opportunity Not Opportunism Report* a good faith obligation is added to the *Code*, the issue of express exclusion will not arise. An obligation to act in good faith will then be a legislative, public duty that cannot be excluded, contracted out of or waived. The question of the role for good faith in the face of inconsistent contractual provisions will nevertheless remain an important issue to be worked through.

C Good Faith as an Independent Source of Obligations

The standard expression of the good faith obligation is that it is implied in relation to the exercise of contractual powers. The issue of whether an obligation of good faith can arise independently of contractual terms has not been authoritatively resolved. Peden suggests that '[i]n Australia there is reluctance to require an obligation of good faith or cooperation that is independent of express terms of the contract'¹⁷⁶ and that '[i]t has been said that to state there is a term requiring good faith without some obligation on which to attach it would be to place the obligation in a "vacuum"'.¹⁷⁷

Cases such as *Far Horizons* nevertheless suggest that the judicial reluctance may be less compelling in the franchising context. In that case, Byrne J rejected the plaintiff's claims that the decision of McDonald's to open two new stores in the vicinity of those already operated by the franchisee was actuated not by legitimate commercial considerations but by a desire to punish the plaintiff franchisee and pressure it to leave or to make an example of it (to warn potentially dissident licensees).¹⁷⁸ The franchisee had rights only to one site, with no territorial exclusivity or contractual right to a further outlet, but McDonald's had not expressly stipulated in the contract that they had the right to open other outlets in the vicinity of the franchisee's outlet.¹⁷⁹ Byrne J commented that:

In the present case, two parties to a contract have interests which are in conflict in the circumstances which have arisen. One party wishes to perform an act which the law ordinarily would permit it to do — to open a new store. This may have an adverse effect upon the other party. The right to perform that act is not conferred by the contract but by the ordinary freedom of a commercial enterprise to pursue a commercial opportunity. The act is not, in terms, prohibited by the contract. The question is not, as in *Renard* ..., whether the right conferred by the contract is fettered by the terms of the contract; rather it is whether the contract between the parties impliedly prohibits or limits the right of one of them to perform an otherwise lawful act. In such a case the contract will operate to prohibit or limit the performance of that act by a party to a contract only

¹⁷⁵ Ibid.

¹⁷⁶ Peden, *Good Faith in the Performance of Contracts*, above n 61, 137.

¹⁷⁷ Ibid 137–8, quoting *NT Power* (2001) 184 ALR 481, 575 (Mansfield J). See generally *Pacific Brands* [2005] Aust Contract Reports ¶90-213, 88 498 (Finkelstein J).

¹⁷⁸ See above nn 124–6 and accompanying text.

¹⁷⁹ *Far Horizons* [2000] VSC 310 (Unreported, Byrne J, 18 August 2000) [129]–[130].

where this prohibition or limitation is necessary for the performance by that party of its obligations under the contract.¹⁸⁰

Byrne J concluded that McDonald's exercise of its right to open a competing store that would have an impact on an existing franchisee was not subject to alleged implied restrictions, at least in circumstances where the franchisee had no exclusive territorial rights.¹⁸¹ His Honour nevertheless stated:

I leave for another day the case where the impact caused by the new store is such that it effectively destroys the business which the impacted operator had bargained for or where the degree of impact is such as to give rise to the inference that its opening was for a purpose which might give rise to the operation of the implied obligation of good faith and fair dealing.¹⁸²

In *Overlook*, the essential question was

whether the relevant implied obligation of good faith inhibits one party in the performance of 'an act which the law [ordinarily would] permit it to do' in exercise of 'the ordinary freedom of a commercial enterprise to pursue a commercial opportunity' ...¹⁸³

Barrett J accepted that there was scope for the operation of an implied obligation of good faith in circumstances which did not involve the exercise of a contractual power or performance of a contractual obligation:

the conduct of Foxtel in reducing the price of the add-on channels falls to be assessed in a context where there was no express or implied contractual provision precluding or regulating alteration of the price by Foxtel and where Foxtel's actions were not taken pursuant to or in purported exercise or fulfilment of any contractual provision.¹⁸⁴

In cases such as *Far Horizons* and *Overlook*, the good faith issue was not tied to contractual provisions. Indeed, the influence of good faith would be greatly reduced if this limitation were absolute.

VI ENACTING A GOOD FAITH OBLIGATION FOR FRANCHISING

In recommending that the *Code* be amended by including a provision imposing a duty on franchisors and franchisees to 'act in good faith' in relation to all aspects of a franchisee agreement, the *Opportunity Not Opportunism Report* quoted the *South Australian Report*:

While an abstract formulation of a generalised concept of good faith may be indistinct, the courts have demonstrated that they are able to know it when they see it, or more properly, they know a breach of it when they see it.¹⁸⁵

¹⁸⁰ Ibid [129].

¹⁸¹ Ibid [130].

¹⁸² Ibid.

¹⁸³ [2002] Aust Contract Reports ¶90-143, 91 972 (Barrett J), quoting ibid [129].

¹⁸⁴ *Overlook* [2002] Aust Contract Reports ¶90-143, 91 972.

¹⁸⁵ *South Australian Report*, above n 16, 55, quoted in *Opportunity Not Opportunism Report*, above n 2, 102.

The 'know it when you see it' test was of course made famous by Stewart J in *Jacobellis v Ohio* in relation to pornography, his Honour commenting: 'I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description ... But I know it when I see it'.¹⁸⁶

The reality is that good faith — like pornography and unconscionability — is, in the absence of clear definition, in the eye of the beholder. Unless there is a clear consensus as to the scope and operation of good faith — which, given Australia's 'bewildering' array of authorities,¹⁸⁷ there is clearly not — the 'know it when you see it' approach is an abdication of legislative responsibility. Even if the judges know it when they see it, the evidence from the Australian courts is that they know this individually and not collectively. In any event, the law is not for the judges but for the community and the prescience of various judges is not necessarily mirrored in the franchising community.

A legislative obligation of good faith in the *Code* would undoubtedly have the capacity for a more liberal interpretation and more influential development than its common law progenitor.¹⁸⁸ It would be freed from the common law restraint noted by Kirby J in the High Court in *Royal Botanic Gardens* — that it 'appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom'.¹⁸⁹ It would be interpreted against the background of extrinsic material which clearly addresses the 'mischief' the amendment would seek to remedy.¹⁹⁰ It could not be excluded by the convenient expedient of an appropriate exclusion clause. It would nevertheless be, at least as currently envisaged, a legislative obligation which encompasses the common law principle. The lessons from the unconscionability regime are instructive. A decade after the introduction of the business unconscionability provision in s 51AC of the *Trade Practices Act 1974* (Cth),¹⁹¹ the interpretation of the core concept — 'unconscionability' — remains unsettled.¹⁹² A broad and general entrenchment of the ethical command 'good faith' raises even more complex and sensitive issues.

One alternative suggested to the Joint Committee was to define 'good faith'.¹⁹³ Given the magnitude of this task it is hardly surprising that the Joint Committee declined the invitation. The Australian Competition and Consumer Commission ('ACCC') was certainly not exaggerating in suggesting that it would be difficult

¹⁸⁶ 378 US 184, 197 (1964).

¹⁸⁷ *Goldspar* (2006) 230 ALR 437, 498 (Gyles J).

¹⁸⁸ Two possible limitations on the scope of the obligation in the form recommended by the *Opportunity Not Opportunism Report* are that it is an obligation of 'good faith' and not 'good faith and fair dealing', and that the obligation relates to the 'agreement' and not the 'relationship': see *Opportunity Not Opportunism Report*, above n 2, 115 (recommendation 8).

¹⁸⁹ (2002) 186 ALR 289, 312.

¹⁹⁰ In the first case involving franchising to be considered by the High Court of Australia, *Master Education Services Pty Ltd v Ketchell* (2008) 236 CLR 101, second reading speeches and explanatory statements with respect to the introduction of the *Code* were highly significant: see at 110 (Gummow ACJ, Kirby, Hayne, Crennan and Kiefel JJ).

¹⁹¹ Inserted by *Trade Practices Amendment (Fair Trading) Act 1998* (Cth) sch 2 item 2.

¹⁹² See generally Senate Standing Committee on Economics, above n 81.

¹⁹³ *Opportunity Not Opportunism Report*, above n 2, 110–13.

to independently define good faith or reduce it to a 'rigid rule'.¹⁹⁴ A more satisfactory alternative is to address specific sector problems by specific legislative solutions.

VII CONCLUSION

Kirby J in *Sanpine* recently observed that:

Because the common law develops from hundreds of judicial decisions, sometimes over long periods of time, it is often the case that the conceptual framework that affords structure to a group of related legal principles is at first imperfect and unclear. It falls to judges and scholars to attempt to derive rules that are coherent, practical, just, and (so far as is possible) conformable with past decisions.¹⁹⁵

Kirby J was writing in the context of the principle that parties should ordinarily fulfil their contractual obligations, but his observation is equally applicable to the current development of the principle of good faith. Commenting specifically on judicial recognition of good faith in *Esso Australia*, Warren CJ referred to 'the conceptual difficulty that can attend the concept of a duty of good faith',¹⁹⁶ which has frequently been avoided by the courts deciding matters on other bases:

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. The modern law of contract has developed on the premise of achiev-

¹⁹⁴ Ibid 103, quoting ACCC, Submission No 60 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Franchising Code of Conduct*, September 2008, 19. A draft model amendment was included in Competitive Foods Australia, Submission No 22 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Franchising Code of Conduct*, September 2008, Attachment 1, quoted in ibid 111–12:

23A Obligation to act in good faith

- (1) A franchisor and a franchisee shall act towards each other in good faith in the exercise of any rights or powers arising under, or in relation to, a franchise or the renewal of a franchise.
- (2) For the purposes of sub-clause (1), good faith in relation to conduct by a franchisor or a franchisee means that the party has acted:
 - (a) honestly and reasonably; and
 - (b) with regard to the interests of the other parties to the franchise,
 in all the circumstances, including without limitation:
 - (c) the commercial and business objects of the franchise;
 - (d) the legitimate business interests of each of the parties, and what is reasonably necessary for the protection of those interests;
 - (e) the respective financial and non-financial contributions made by each of the parties to the establishment and conduct of the franchised business;
 - (f) the risks taken by each of the parties in the establishment and conduct of the franchised business;
 - (g) the alternative courses of action available to the parties in respect of the matter under consideration; and
 - (h) the usual practices in the industry to which the franchise relates.

¹⁹⁵ (2007) 233 CLR 115, 152.

¹⁹⁶ [2005] VSCA 228 (Unreported, Warren CJ, Buchanan JA and Osborn AJA, 15 September 2005) [2].

ing certainty in commerce. If good faith is not readily capable of definition then that certainty is undermined.¹⁹⁷

In contrast, the *Opportunity Not Opportunism Report* argued that the introduction of an express obligation of good faith will ‘provide a clear, overreaching statement of expectation as to the standard of conduct that should be adopted by franchisors, franchisees and prospective franchisees.’¹⁹⁸ As magnificent as this sentiment undoubtedly is, it has the potential to propel the franchising sector into a new era of uncertainty, disputation and litigation, with notions of good faith being sought to be applied to an indeterminate range of real and imagined grievances and breaches. The Joint Committee acknowledged but was unmoved by the submission of the ACCC (that a good faith obligation ‘may introduce ambiguity and confusion about the rights and responsibilities of franchisors and franchisees, and potentially increase disputes and conflict among franchising participants’)¹⁹⁹ and the evidence of its Chairman, Mr Graeme Samuel, who was concerned that an explicit good faith clause in the *Code* may add to the expectation gap in franchise relationships:

On top of the prescriptive requirements of the *Franchising Code of Conduct* and of the relatively low threshold of misleading and deceptive conduct, that is, have you been honest or have you been dishonest, layer on top of that this somewhat hazy, woolly concept of good faith, and all I can say to you is that we will end up having an increased expectation gap where people will say, ‘But I believe that the franchisor did not act in good faith, and the ACCC wouldn’t deal with it.’²⁰⁰

The assumption of the *South Australian Report* — that, ‘[w]hile an abstract formulation of a generalised concept of good faith may be indistinct, the courts have demonstrated that they are able to know it when they see it, or more properly, they know a breach of it when they see it’²⁰¹ — is misconceived or, at least, too optimistic. The report’s endorsement of the proposition that ‘a statutory duty of good faith would be one way to make explicit the underlying ethical standards expected of the industry as a whole’²⁰² is naive and troubling. The statement of the *Opportunity Not Opportunism Report* that despite no clear definition of good faith this concept ‘would be generally understood to mean acting fairly, reasonably and honestly, encapsulating the concept of “a fair go”’²⁰³ is concerning.

The concept of good faith has gained traction as the solution to all real and imagined ills within the franchising sector. For those agitating for reform it has

¹⁹⁷ Ibid [3].

¹⁹⁸ *Opportunity Not Opportunism Report*, above n 2, 114–15.

¹⁹⁹ Ibid 103, quoting ACCC, Submission No 60 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Franchising Code of Conduct*, September 2008, 19.

²⁰⁰ *Opportunity Not Opportunism Report*, above n 2, 103–4, quoting Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, 5 November 2008, 96 (Graeme Samuel, Chairman, ACCC).

²⁰¹ *South Australian Report*, above n 16, 55.

²⁰² Ibid 54; see also at 55–9. See also *Opportunity Not Opportunism Report*, above n 2, 107.

²⁰³ *Opportunity Not Opportunism Report*, above n 2, 102 (citations omitted).

assumed symbolic significance and, if introduced, would be argued to accommodate circumstances beyond any appropriate sphere of influence. 'Good faith' is a seductive concept for franchisees and for the franchise regulators, but it will not be interpreted by the courts to provide the universal solvent the knights of good faith seek. The Aussie mantra of 'a fair go' is a beautiful thing but the operation of good faith will be interpreted much more narrowly. The perception that 'good faith' is the universal solution is both misleading and dangerous, but is given life by the equating of good faith with good ethics. A principle of good faith must presumably accord with ethical standards and community values, but is not, and should not be, a concept the content of which is defined by them.

While an understanding of good faith as requiring 'a fair go' would be enthusiastically perceived as a panacea for both the real and imagined ills of the sector, the reality of good faith as a legal concept is quite different. If franchisor opportunism is a problem warranting legislative intervention, this should be addressed by carefully crafted legislative responses rather than by defaulting to an undefined and overreaching standard of indeterminate scope and application.

VIII POSTSCRIPT

On 5 November 2009, the Commonwealth government released its response to the *Opportunity Not Opportunism Report*.²⁰⁴ The government rejected the Joint Committee's recommendation for the introduction of an overarching standard of good faith to be incorporated into the *Code*:

While accepting the intent of Recommendation 8, there are some difficulties with the suggested approach. The law on good faith is still evolving and there is not a single definition or standard set of behaviours that constitute good faith. The inclusion of a general obligation of good faith in the *Franchising Code* would increase uncertainty in franchising. Neither franchisors nor franchisees would be certain of the occurrence of a breach: court proceedings would be required to establish whether or not there had been a breach.

The extra uncertainty created by the inclusion in the *Franchising Code* of a general, undefined good-faith obligation could be expected to have adverse commercial consequences for franchisees.²⁰⁵

The government's approach is that specific issues 'should be dealt with by measures which will address specific behavioural concerns.'²⁰⁶ The government regarded this response as one that is 'legally feasible and avoids undesirable

²⁰⁴ Australian Government, *Commonwealth Government Response to the Report of the Parliamentary Joint Committee on Corporations and Financial Services — Opportunity Not Opportunism: Improving Conduct in Australian Franchising* (2009) <<http://www.innovation.gov.au/Section/SmallBusiness/Pages/FranchisingCodeofConduct.aspx>>.

²⁰⁵ Australian Government, *Additional Information on Franchising Code and Unconscionable Conduct Reforms* (2009) 1 <<http://minister.innovation.gov.au/Emerson/Documents/Additional%20information%20on%20Franchising%20Code%20and%20Unconscionable%20Conduct%20reforms.pdf>>. See also *ibid* 13.

²⁰⁶ Australian Government, *Commonwealth Government Response to the Report of the Parliamentary Joint Committee on Corporations and Financial Services*, above n 204, 5.

commercial consequences for franchising' as well as 'avoid[ing] unnecessary uncertainty and associated extra costs for franchisees and franchisors.'²⁰⁷

²⁰⁷ *Ibid* 13.

Regulating the Franchise Relationship: Franchisor Opportunism, Commercial Morality and Good Faith

Andrew Terry and Cary Di Lerna*

Abstract. As franchising increases its influence internationally, regulators increasingly face the challenge of the appropriate manner of its regulation. A recent Australian report has focussed attention on an obligation of good faith as an appropriate regulatory strategy to address opportunistic conduct and has concluded that while the prior disclosure obligations of Australia's regulatory instrument for franchising (the *Franchising Code of Conduct*) are for the most part adequately addressed, there remain concerns because of the 'continuing absence of an explicit overarching standard of conduct for parties entering a franchise agreement'. The *Opportunity not opportunism* report of the Parliamentary Joint Committee on Corporations and Financial Services (December 2008) recommended that the optimal way to provide a deterrent against opportunistic conduct in the franchising sector was 'to explicitly incorporate, in its simplest form, the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith'. In November 2009 the Australian Government rejected this recommendation on the basis that it would 'increase uncertainty in franchising'. This paper explores the challenges faced in grafting the civil law concept of good faith onto a common law system. It suggests that in Australia and other common law jurisdictions – and even in civil law jurisdictions – good faith is more an elusive ideal than a well settled commercial standard and that issues of definition, scope and application may frustrate its intended application in the franchising context.

Keywords: Regulation, good faith, relational contracts, fair dealing

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1 Introduction

In 1998 Australia joined the then small group of countries which regulated their franchise sectors under specific franchise laws rather than simply relying on underlying commercial laws of general application to all business enterprises, albeit supplemented in many cases by voluntary self regulatory codes of practice (Terry, 2007). The influential 1997 Fair Trading Report, *Finding a Balance – Towards Fair Trading in Australia* catalogued a litany of inappropriate conduct in relation to small business in general and franchising in particular that left the government little option but to act. The *Franchising Code of Conduct* which mandates prior disclosure, regulates aspects of the relationship, and requires mediation as a prerequisite to arbitration or litigation (prescribed as a Regulation under the *Trade Practices Act* 1974 (Cth)) and the introduction of a business unconscionability provision (under section 51AC of the *Trade Practices Act*) was the legislative response (Giles et al., 1998). These initiatives, in combination with the general prohibition of misleading and deceptive conduct (under s 52 of the *Trade Practices Act*) extend to Australian franchisees arguably the world's most comprehensive regulatory safety net.

Despite the concerns of UK franchising specialist Martin Mendelsohn (1999) that 'the new Australian regulation makes Australia the least desirable destination in the world for franchise systems' and his advice that 'franchisors should avoid Australia until they had nowhere else to go, and even then it would be a close call', the Australian experience has been positive. The Australian franchising sector has been prepared to accept regulatory measures to protect the image and credibility of the sector (Franchising Policy Council, 2000) and the Franchise Council of Australia, the peak industry body, acknowledges that there is 'overwhelming support for the Code' which has had a 'beneficial effect on the franchising sector' since its introduction (Franchise Council of Australia, 2000).

Despite the strong regulatory regime in Australia, the pressure for further and better protection continues. The *Fair Trading Report* referred to over twenty previous reports at regular intervals since 1976 – only a few years after the first golden arches were erected in Australia providing the catalyst for the development of domestic franchising – addressing business conduct issues either generally or in the specific context of franchising. In 2008 alone, there were three parliamentary inquiries – Western Australia (April 2008) and South Australia (May 2008) and Federal. The latest and most influential report – *Opportunity not opportunism: improving conduct in Australian Franchising* – of the Federal Parliamentary Joint Committee on Corporations and Financial Services (December 2008) concluded that while the Code's prior disclosure obligations are 'for the most part adequately addressed' there remain concerns because of the 'continuing absence of an explicit overarching standard of conduct for parties entering a franchise agreement'. The Committee commented that

...the interdependent nature of the franchise relationship leaves the parties to the agreement vulnerable to opportunistic conduct by either franchisors or franchisees. Franchisee opportunism

may take the form of free riding, unauthorised use of franchisors' intellectual property rights, under-performance, or failure to accurately disclose income. However, the franchisor's control over the provisions in the contract enables franchisors to address opportunistic behaviour of this kind by enforcing the terms of the franchise agreements.

Franchisor opportunism was described as 'predatory conduct and strong arm tactics by franchisors' involving the exploitation of a pre-existing power relationship between the franchising parties, which makes the franchisee 'vulnerable or economically captive to the demands of the franchisor'. There is an inherent and necessary imbalance of power in franchise agreements in favour of the franchisor, but abuse of this power can lead to opportunistic practices including encroachment, kickbacks, churning, non-renewal, transfer, termination at will, and unreasonable unilateral variations to the agreement.

The Committee concluded that the optimal way to provide a deterrent against opportunistic conduct in the franchising sector was 'to explicitly incorporate, in its simplest form, the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith'. It recommended that the following new clause be inserted into the *Franchising Code of Conduct*:

Standard of Conduct

Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.

This paper assesses this recommendation which, although superficially attractive, is not the panacea its proponents expect it to be.

This paper is organised as follows: Section 2 examines the nature of the franchise relationship and the challenges its relational and standard form elements pose for regulators. Section 3 addresses the potential role of a good faith obligation to meet these challenges. Section 4 addresses the challenges in formulating a concept of good faith and section 5 examines international precedents. The paper concludes that good faith is more an elusive ideal than a well settled commercial standard and that issues of definition, scope and application may frustrate its intended application. Such considerations were influential in the Government's rejection of the recommendation for a stand alone and overarching good faith obligation in the *Code* on the basis that '[t]he extra uncertainty created by the inclusion in the Franchising Code of a general, undefined good-faith obligation could be expected to have adverse commercial consequences for franchisees' (Additional Information on Franchising Code and Unconscionable Conduct Reforms, 2009).

2 'Not an Ordinary Commercial Contract'

In *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* (2002) the Privy Council acknowledged that franchise agreements were 'not ordinary commercial con-

tracts'. The *Dymocks* case provided the first opportunity in Anglo-Australasian jurisdictions for a superior court to explore the jurisprudential nature of franchising, and the reason why franchising agreements were not ordinary contracts. Unfortunately this opportunity was not taken up and the academic literature addressing this issue was not referred to by the Privy Council. The nature of the franchisor/franchisee relationship and the contract which enshrines it are nevertheless attracting increasing attention (Terry, 2005; Dixon, 2007 and 2005; Paterson, 2001, Terry and Di Lernia, 2009), and there is increasing recognition, academic if not judicial, that franchising is a *relational* contract, which Dr Elizabeth Spencer (2008) has described as follows:

Relational contracts are defined by features of incompleteness and longevity. Relational contracts must be flexible, sometimes to the point of being vague. There is often a high level of discretion accorded to the parties, and such contracts therefore rely heavily on reciprocity and on trust that develops over time between the contracting parties.

Franchising exists in a world of 'contractual incompleteness and relational complexity' in which

... the parties are not strangers; much of their interaction takes place "off the contract", mediated not by visible terms enforceable by a court, but by a particular balance of cooperation and coercion, communication and strategy (Hadfield, 1990).

These characteristics pose a challenge to regulators. The extra-legal norms which explain relational contracting in the context of contracting equals – where self interest generally leads to acceptable outcomes – are nevertheless not as compelling in the context of the typical business format franchise which is characterised by both an *information* and a *power* imbalance (Spencer, 2006).

The *information imbalance* which characterises the typical business format franchising relationship is typically redressed by prior disclosure. The case for legislation remedying the information imbalance by mandating prior disclosure is widely accepted today. Prior disclosure obligations are not regarded as a restriction on business but as a 'common sense and firm basis for doing business within the peculiarly close relationship of a franchise and in accordance with normal business practice' (Trade Practices Consultative Committee, 1979).

The *power imbalance* raises more sensitive issues. The case for legislation addressing the power imbalance has less support as it raises difficult questions of fairness and the appropriate allocation of risk in entrepreneurial activities. UNIDROIT's *Model Franchise Disclosure Law* 2002 for example deliberately deals exclusively with prior disclosure issues and does not trespass into the area of appropriate conduct within the relationship. It can be argued that prior disclosure is the key to franchise reform and that it is the function of the disclosure statement to warn potential franchisees not to enter into agreements that they regard as potentially imposing unduly onerous obligations. There is nevertheless increasing regulatory attention to standards of conduct and relationship issues arising out of the power imbalance and greater acceptance that unduly onerous obligations and opportunistic conduct need to be addressed as part of a regulatory scheme to over-

come the limitations of classical contract law in accommodating the realities of the relational franchise model.

3 Good faith and the Franchise Relationship

The concept of good faith plays an important role in most legal systems. It is a concept familiar to the civil law in which under the Civil Codes it provides the ultimate point of reference for contractual obligations. The common law however has not evolved any general requirement of good faith. As noted by Brereton J in the NSW Supreme Court in *Hunter Valley Skydiving Centre Pty Ltd v Central Coast Aero Club Ltd* (2008), good faith does not ‘neatly fit into the structure of Australian contract law’ or for that matter, the common law more generally. However, it does not follow that the common law is ‘the hard headed Dickensian ogre that this would at first sight lead one to believe’ (Whittaker and Zimmerman, 2000), for the common law has developed specific solutions to particular problems said to arise by virtue of the nature of classical contract law. A range of general and legislative provisions make provision for specific matters addressing specific contractual fairness issues. Indeed, it has been stated that the ‘mistrust of Anglo-Saxon jurists for the general concept of good faith is equalled only by the imagination which they put towards multiplying particular concepts which lead to the same results’ (Michel, 1998).

The ‘device’ increasingly looked to modify the inflexibility of traditional, classical common law contract theory in relational settings such as the franchise relationship is good faith. Hadfield argues that ‘the doctrinal tool relied on to bring ‘the resolution of franchise contract disputes into line with the realities of the franchise relation[ship]’ (Hadfield, 1990) is invariably the implied term of good faith. However, as noted above, an overarching good faith obligation sits uneasily in the common law and judicial support for this proposition is scant. In Anglo-Australasian jurisdictions the proposition of a New Zealand judge, Thomas J, in a dissenting judgment in *Bobux Marketing Ltd v Raynor Marketing Ltd* (2002), stands virtually in splendid isolation:

The norms of the ongoing relationship, of necessity, tend to supplement the express contractual obligations. Good faith is required to ensure that the requisite communication, co-operation, and predictable performance occurs to the advantage of both parties. In short, the obligation seeks to hold the parties to the promise implicit in the continuing relational commercial transaction.

Outside legislative direction, an obligation of good faith can arise in a franchise agreement in three ways – as an express term of the contract, as a term implied in fact on an *ad hoc* basis to give business efficacy to the contract, or as a term implied in law as a necessary incident of the contract. A fourth possibility – that the obligation of good faith is a principle of construction which is ‘inherent in all common law contract principles’ – would mean that the implication of independ-

ent terms requiring good faith is an ‘unnecessary and retrograde step’ (Carter et al., 2007) and has little judicial support.

The implication in law of a term of good faith as a necessary incident of the contract is not widely supported throughout the common law world. The recent decision of Singapore’s Court of Appeal in *NG Giap Hon v Westcomb Securities Pte Ltd* (2009), which raised ‘important issues of principle centring around the inherently problematic doctrine of the implied term of good faith’, is broadly typical of the common law’s less than enthusiastic attitude. The Court of Appeal noted that this issue had given rise to ‘significant controversy’ in other common law jurisdictions and was raised in the present appeal for the first time in Singapore. The Court held that a term of good faith should not be implied in law in an agency agreement:

The doctrine of good faith is very much a fledgling doctrine in English and (most certainly) Singapore contract law. Indeed, a cursory survey of the relevant law in other Commonwealth jurisdictions appears to suggest a similar situation. This is, perhaps, not surprising in view of the fact that, even in the academic literature (which has witnessed the most discussion as well as analysis of the doctrine), there are differing views as to what the doctrine of good faith means as well as how it is to be applied. Indeed, the copiousness as well as the variety of (and, perhaps more importantly, the debates in) the academic literature (coupled with the relative dearth of case law) suggest that the doctrine of good faith is far from settled. The case law itself appears to be in a state of flux.

Among the common law jurisdictions, Australia has generated most discussion. There is wide, albeit not unanimous support for the 1999 proposition of Finkelstein J in the Federal Court in *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) that ‘in appropriate contracts, perhaps even in all commercial contracts, such a term will ordinarily be implied: not as an ad hoc term (based on the presumed intention of the parties) but as a legal incident of the relationship’. In *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* (2005) the Victorian Court of Appeal was reluctant to endorse the implication of a term of good faith as a legal incident of commercial contracts. The Court expressed a preference for ‘ad hoc implication...rather than implication as a matter of law creating a legal incident of contracts of a certain type’. The Court nevertheless qualified its reservation and was...

...reluctant to conclude that commercial contracts are a class of contracts carrying an implied term of good faith as a legal incident, so that an obligation of good faith applies indiscriminately to all the rights and powers conferred by a commercial contract. It may, however, be appropriate in a particular case to import such an obligation to protect a vulnerable party from exploita-

tive conduct which subverts the original purpose for which the contract was made.

4 Formulating a Concept of Good Faith

Judicial acceptance within the common law world that an implied term of good faith is a necessary incident of a franchise contract is only the beginning. The real challenge is to be found in formulating the concept precisely enough not to cause havoc in the law. The difficulty in defining what has been described as a 'contextual standard' and a 'generalisation of universal application' (*Hughes Aircraft Systems International v Airservices Australia* (1997)) is identifying its precise boundaries. At present, the scope of the duty remains elusive. Although there is an increasing body of case law most judgments advocating recognition of the concept 'appear incoherent and contain little legal principle' (Peden, 2003). In *Council of the City of Sydney v Goldspar Australia Pty Limited* (2006) Gyles J described the variety of opinions in both the authorities and the commentaries as 'bewildering' and noted that approaches vary from the 'cautious' to the 'adventurous'. Paterson argues that 'Australian case law has relied on synonyms or isolated examples to explain the duty, an approach which leaves much unanswered' (Paterson, 2001). Such an approach impacts negatively on legal certainty and does not help in setting a standard for franchisees and franchisors to aspire to in their dealings.

4.1 The meaning of good faith

Perhaps the best known approach to understanding the potential content of a good faith obligation is Summers' *excluder* doctrine advanced in his seminal Virginia Law Review article (Summers, 1968). Professor Summers saw good faith as a phrase which 'has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith'. However, this approach fails to provide a clear idea of what observance of the standard would actually require:

[I]t seems tantamount to saying that the good faith duty is breached whenever a judge decides that it has been breached... [which] hardly advances the cause of intellectual inquiry and provides absolutely no guide as to the disposition of future cases except to the extent that they may be on all fours with a decided case (Bridge, 1984).

The excluder approach does not appear able to provide any real guidance to courts or contracting parties as to whether the supposed duty might be breached by particular actions. This leads to an undesirable lack of certainty in commercial arrangements.

Two more comprehensive formulations which have some support are provided by two distinguished judges writing extra-judicially. Lord Steyn incorporates a subjective element, a 'threshold requirement ... that the party must act honestly', as well as an objective element requiring the 'observance of reasonable commer-

cial standards of fair dealing in the conclusion and performance of the transaction concerned' (Steyn, 1997). Sir Anthony Mason (2000) states that

...the concept embraces no less than three related notions: (1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself); (2) compliance with honest standards of conduct; and (3) compliance with standards of conduct which are reasonable having regard to the interests of the parties.

The duty to cooperate to achieve contractual objects is an accepted legal duty for all contracts under the common law. In the words of Griffith CJ in *Butt v M'Donald* (1896), 'It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other to have the benefit of the contract'. The idea that good faith requires parties to act honestly, and therefore that acting dishonestly connotes bad faith conduct, is uncontroversial. A standard of "honesty" nevertheless poses an evidentiary challenge to a franchisee and will not catch many forms of behaviour which although characterised by honest conduct will impact negatively and significantly upon the interests of the contractual counterparty.

Lord Steyn's objective element, and Sir Anthony Mason's third requirement, relating to reasonable commercial standards pose more serious difficulties. In relation to the exercise of a termination clause by a franchisor there is judicial support in Australia for the proposition that 'provide the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied' (see *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999)). While reasonableness provides a platform from which to explore the content of the supposed good faith obligation, this approach has been criticised as being 'more confusing than instructive':

There is no precise meaning given, but rather a repetition of well-worn phrases and quotes, without explanation of how and why they fit together. There is, furthermore, no explanation of why "reasonableness" is a justified inclusion in the meaning of good faith, and why it is considered identical to "good faith" (Peden, 2003).

In *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) it was noted that 'in ordinary English usage there has been constant association between the words fair and reasonable. Similarly there is a close association of ideas between the terms unreasonableness, lack of good faith and unconscionability'. This is of great import to any definition of good faith involving reasonableness, for it can be argued that 'a requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith' (Stapleton, 1999). In any event as Bowen LJ cautioned over a century ago in *Mogul Steamship Co. v McGregor, Gow & Co.* (1889):

I should deem it to be a misfortune to attempt to adopt some standard of judicial “reasonableness” to which commercial adventurers were bound to conform.

The caution of Bowen LJ still retains much of its original force.

The quest for a more specific formulation to accommodate the underlying need for certainty in franchise relationships has led to the idea that good faith should preclude opportunistic conduct or the use of contractual terms for purposes antithetical to the contract. In *Far Horizons Pty Ltd v McDonald’s Australia Ltd* (2000), Byrne J stated that good faith would oblige ‘each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose’. In fleshing out such a conception however, as stated by Barrett J in *Overlook v Foxtel* (2002) ‘it becomes necessary to enquire about the extent to which selflessness is required’. While franchise contracts do not embody any sort of fiduciary relationship, Barrett J stated that good faith requires a party to ‘recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms’, although the interests of the other party are not paramount (see *Mason v. Freedman* (1958), cited in *Shelanu Inc. v. Print Three Franchising Corp.* (2003)). If this be the case, the logical question which follows concerns the divining of “legitimate interests”. Would such interests be inferred from the contract alone or would exogenous sources of information such as extra-contractual norms developed as part of the ongoing relationship play a role in determining whether legitimate interests had been controverted?

Should the former approach be taken, the weight of the standard form contract drafted in the interests of the stronger franchisor would not assist the franchisee except in cases of obvious abuse, such as in *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000), where the statutory unconscionability provisions provided relief. Hadfield (1990) argues that consideration should be given to the continuing relationship and the expectations engendered therein. This suggests another approach to good faith which is to consider the “reasonable expectations” of parties to a contract. Under this approach a court may be able to take a more balanced approach to franchising disputes by allowing franchisees, who might have had their legitimate expectations of contractual performance frustrated and are not otherwise able to make a case in situations where they do not possess formal “legitimate interests” as specified in a written contract, a valid avenue for redress they otherwise would not have had. However, as noted by Professor Summers (1968), ‘[i]n most cases the party acting in bad faith frustrates the justified expectations of another [and] the ways in which he may do this are numerous and radically diverse’. Possibly for this reason, the reasonable expectations approach has received little judicial attention.

An important consideration in the use of the reasonable expectations approach as noted by Iglesias (2004) is that ‘what a party can reasonably expect must be determined not on subjective hopes, but on economic reality’. Even the good faith sceptic, Professor Michael Bridge (1984), suggests that the reasonable expecta-

tions approach might just fit the necessary requirements for a standard of good faith stating that reference to justified expectations ‘is much more satisfactory than good faith as a guide to the resolution of practical problems’. An important concern is the evidentiary burden of proving the reasonable existence of such expectations and ensuring franchisees actual and potential do not get swept up in any false expectations of the power of “good faith”, and all that term connotes. Any approach cloaked in the language of ‘good faith’ may give serve to disappoint franchisees by providing false hope that unsupported subjective hopes may trump hard contractual terms and unforgiving economic reality.

4.2 The limitations on good faith

Even if the meaning of good faith can be determined with sufficient precision to be practically and commercially useful, an important cluster of issues which the meagre case law has only incompletely addressed surrounds the role of good faith in the context of contractual provisions. Questions arise as to whether a requirement of good faith would be able to impose obligations on contracting parties inconsistent with other terms of the contract, whether the duty can be excluded by the parties, and whether good faith can function as an independent source of obligations or is it limited to bad faith violations of express terms?

In *Ingot Capital Investments v Macquarie Equity Capital Markets* [No. 6] (2007) the New South Wales Supreme Court stated:

[I]t is plain that no duty of good faith can be implied where the duty...is inconsistent with an express term of the contract...
[E]ven if there is no direct conflict between the term sought to be implied and any express term of the contract, the express terms of the contract as a whole may negate the implication.

Determining whether a contract taken as a whole might limit the operation of a good faith obligation may prove a complex exercise in legal sophistry for as explained by Greenwood J in *Luce Optical v Budget Specs (Franchising)* (2005):

Good faith is an incident of every commercial contract unless the duty is excluded expressly or by necessary implications and that duty operates as a fetter upon the exercise of discretion and powers conferred by the contract...

The next set of questions concern the contractual exclusion of the operation of an obligation of good faith. While an implied term of good faith cannot defeat the use of clause expressly excluding it the question of whether “entire agreement” clauses have the effect of excluding the implied obligation of good faith is less certain. Finn J in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) considered that under Australian law, an “entire agreement” clause does not preclude implications ad hoc, and found ‘arresting’ the suggestion that an entire agreement clause is ‘of itself sufficient to constitute an express exclusion of

an implied duty of good faith and fair dealing where that implication would otherwise have been made by law’.

A third set of questions which arises is whether an obligation of good faith can arise independently of contractual terms. This question is yet to be authoritatively resolved. Professor Peden suggests that ‘in Australia there is reluctance to require an obligation of good faith or cooperation that is independent of express terms of the contract’ and to ‘state there is a term requiring good faith without some obligation on which to attach it would be to place the obligation in a “vacuum”’ (Peden, 2003).

4.3 The Reality of Good Faith

While the Singapore Court of Appeal does not speak for the common law world its reason for not endorsing an implied duty of good faith in the Singapore context resonates more widely. In *NG Giap Hon v Westcomb Securities Pte Ltd* (2009) the Court of Appeal stated that

...it is not surprising that the doctrine of good faith continues to be a fledgling one in the Commonwealth. Much clarification is required, even on a theoretical level. Needless to say, until the theoretical foundations as well as the structure of this doctrine are settled, it would be inadvisable (to say the least) to even attempt to apply it in the practical sphere.

Although the *Opportunity not opportunism* (2008) report optimistically accepted that ‘while an abstract formulation of a generalised concept of good faith may be indistinct the courts have demonstrated that they are able to know it when they see it, and more properly, they know a breach of it when they see it’, the Singapore Court of Appeal provides salutary caution that the content and application of good faith remains ambiguous and uncertain. Whittaker and Zimmermann (2000) have cautioned that, even under the civil law, good faith is not a legal rule ‘with specific requirements that have to be checked but may be called an ‘open’ norm [the content of which] cannot be established in an abstract manner but takes shape only by the way in which it is applied’. While defining good faith is an improbable exercise in a civil law jurisdiction and an extremely challenging exercise in a common law jurisdiction, it is nevertheless of a lesser degree of difficulty than determining what the obligation demands in a particular case. This is a challenge which faces both the civil law and the common law.

5 Legislating a Good Faith Obligation

The Australian recommendation was to legislatively mandate good faith in the franchising context by adding to the *Franchising Code of Conduct* the requirement that ‘Franchisors, franchisees, and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement’. In civil law jurisdictions good

faith exists as an underlying principle for contracts generally and there are a number of precedents in common law jurisdictions. China, Italy, Korea, and four Canadian provinces specifically address good faith. Other regulated regimes, such as Australia under the current *Code*, do not address general standards of conduct but nevertheless specifically address particular conduct issues in relation to, for example, termination and transfer. Beyond the general or specific conduct provisions of dedicated franchise laws the underlying laws of general application may of course have a significant impact in prescribing general ethical standard. In Australia for example the statutory prohibitions of “misleading conduct” and “unconscionable conduct” under the *Trade Practices Act 1974* (Cth) have been particularly influential in raising standards of conduct within the franchising sector (Giles et al., 1998).

China’s *Commercial Franchise Regulation* 2007 requires that: ‘Franchising activities shall be conducted in compliance with the principles of free will, fair dealing, honesty, and good faith’ (article 4). Korea’s *Fair Franchise Transactions Act* 2002 provides that ‘In engaging in the operation of a franchise the franchising parties shall perform their respective duties based on the principles of trust and good faith’ (article 4). Italy’s *Rules on the Regulation of Franchising* 2004 lay down a duty of good faith in relation to precontractual behaviour: ‘The franchisor must exercise loyalty, fairness and good faith at all times in its dealings with the prospective franchise ...’ (article 6). Malaysia’s *Franchise Act* 1998 does not impose a specific good faith obligation but nevertheless requires that ‘A franchisor and a franchisee shall act in an honest and lawful manner and shall endeavour to pursue the best franchise business practice of the time and place.’ (s.29(1)).

The most useful analogy from an Australian perspective is that of Canada. The *Uniform Franchise Act* 2005, a model law, provides that:

3. Fair dealing

(1) Every franchise agreement imposes on each party a duty of fair dealing in the performance and enforcement of the agreement, including in the exercise of a right under the agreement.

Right of action

(2) A party to a franchise agreement has a right of action for damages against another party to the franchise agreement who breaches the duty of fair dealing.

Interpretation

(3) For the purpose of this section, the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

This provision specifically exists in the laws of Alberta (*Franchises Act*, 2005) New Brunswick (*Franchises Act*, 2007), Ontario (*Arthur Wishart Act (Franchise Disclosure)*, 2000) and Prince Edward Island (*Franchises Act*, 2005) but, as Shannon O’Byrne (2004) argues, a good faith obligation exists in the other provinces either as part of the common law or, in Quebec, a civil law jurisdiction, under the *Civil Code* which includes the requirement that ‘the parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is

performed or extinguished' (art. 1375) and which subjects contracts generally to a good faith obligation.

The good faith obligation in Canada – whether arising from the common law, from the dedicated franchise laws or from the Quebec Civil Code – has been applied in a variety of circumstances seemingly without controversy although the Supreme Court of Canada has not yet had the opportunity to consider its application, scope and operation in a franchising context (O'Byrne, 2004). It is argued that the doctrine is 'constructive because it expressly prohibits capriciousness improper motive, dishonesty, unreasonableness, opportunistic behaviour and ambush' (Stack, 1999). Meehan J in the Ontario Superior Court of Justice in *Elite Specialty Nursing Services Inc. v Ontario* (2002) has indeed observed that 'explicit recognition of the duty of good faith in performance of a contract simplifies and clarifies the law. Contrary to the views of its detractors ... explicitly recognising the doctrine makes the law more certain, more understandable, and, of course, more fair'. These views are not, as noted elsewhere, held by all commentators, and the benign Canadian experience is not mirrored in the United States. Section 1-203 of the *Uniform Commercial Code* provides that '... every contract a duty within this *Act* imposes an obligation of good faith in its performance or enforcement' (see also Section 205 of the Restatement (2nd) of Contracts). Section 1-203 provides the best known example of a legislated underlying good faith obligation but the franchising case law clearly suggests that the substantive difficulties of meaning, application and scope are not removed by the legislative direction. Pitegoff and Garner (2008) suggest that

...although the covenant of good faith and fair dealing probably is law in most jurisdictions, there are very few cases where that principle, by itself, has led to a ruling favourable to a franchisee. Several courts have held that no cause of action exists for an alleged violation of the covenant in the absence of an allegation of violation in bad faith of an express term of agreement.

The meaning of the concept remains uncertain and the issue of whether it can operate as an independent source of obligations independently of contractual provisions remains undetermined. As the Singapore Court of Appeal has recently observed in *Ng Giap Hon v Westcomb Securities Pte Ltd* (2009), 'substantive difficulties with the doctrine of good faith [exist] even in jurisdictions where it has been legislatively mandated'.

Such considerations were implicit in New Zealand's recent decision not to introduce franchise specific regulation 'at this time' (Ministry of Economic Development, 2009). In relation to the mooted proposal to mandate "good faith" the Cabinet paper expressly refers to the uncertainty and added potential for litigation that would be created by such an obligation:

'Good faith' is a term which is not unusual in relational contracts. However, there is no consistent or accepted definition of good faith and the courts in New Zealand have been cautious

about implying a general duty of good faith into contracts. There are diverging judicial views about whether good faith is to be implied either in all commercial contracts, types of commercial contracts (eg. franchises), or on a case by case basis, what the precise content of good faith obligations might be, what would constitute a breach of these obligations, and what the consequences should be.

The common law is therefore unclear and if good faith was legislated for, it would likely take some time before the court established the key principles that would underpin such an obligation in the context of franchising.

Similar considerations influenced the Commonwealth Government's Response to the report of the Parliamentary Joint Committee (2009) for the introduction of an overarching standard of good faith to be incorporated in the *Franchising Code of Conduct*:

While accepting the intent of [the] Recommendation ... there are some difficulties with the suggested approach. The law on good faith is still evolving and there is not a single definition or standard set of behaviours that constitute good faith. The inclusion of a general obligation of good faith in the Franchising Code would increase uncertainty in franchising. Neither franchisors nor franchisees would be certain of the occurrence of a breach: court proceedings would be required to establish whether or not there had been a breach.

The extra uncertainty created by the inclusion in the Franchising Code of a general, undefined good-faith obligation could be expected to have adverse commercial consequences for franchisees.

The Government's approach is that specific issues 'should be dealt with by measures which will address specific behavioural concerns'. This approach is 'legally feasible and avoids undesirable commercial consequences for franchising [including] unnecessary uncertainty and associated extra costs for franchisees and franchisors'.

6 Conclusion

The omnipresent problem with good faith is that it is, in the words of Professor Michael Bridge (1984), 'an imperfect translation of an ethical standard into legal ideology and legal rules'. This is an issue which transcends legal systems. Although the "good faith debate" is frequently presented in a civil law versus common law context the positions are not as entrenched as commonly assumed.

Whittaker and Zimmermann (2000) for example argue that ‘The position in English law appears to be much less unequivocal than a continental lawyer faced with some of these general propositions might be led to expect. Conversely, the civilian approach is much less uniform than a common law lawyer might be led to believe’. The enduring and common issue for any system that embraces good faith as a guiding proposition is ultimately to determine its meaning, its scope, its limitations. Irrespective of the heritage of the legal system which embraces the concept it ‘is not a legal rule with specific requirements that have to be checked but may be called an “open” norm. It cannot be established in an abstract manner but takes shape only by the way in which it is applied’ (Whittaker and Zimmermann, 2000). Good faith, as Mackaay and Leblanc (2003) argue, is ‘an open-ended concept or principle rather than a specific rule’ and ‘the mould in which have been fashioned a range of more specific concepts that have started to lead a life of their own in case law and legal scholarship’.

The concept of “good faith” has gained traction as the solution to all real and imagined ills within the franchising sector and, for those agitating for reform, has assumed symbolic significance. A workable definition of good faith is elusive, but without it a stand-alone obligation of good faith would thrust the franchise sector into an era of uncertainty, disputation and litigation with breaches of good faith being sought to be applied to an indeterminate range of real and imagined grievances (see generally Zaid, 2003). As the authors have written elsewhere, ‘[i]f franchisor opportunism is a problem warranting legislative intervention this should be addressed by carefully crafted legislative responses rather than by defaulting to an undefined and overreaching standard of indeterminate scope and application’ (Terry and Di Lernia, 2009). This was the preferred option of the Australian Government which has determined that the imperative that franchisors and franchisees act in good faith is better addressed by measures which will address specific behavioural concerns.

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