SHOPPING CENTRE
COUNCIL OF AUSTRALIA

Submission to Senate Economics Committee Inquiry

"The Need to Develop a Clear Statutory Definition of Unconscionable Conduct for the Purposes of Part IVA of the Trade Practices Act 1974 and the Scope and Content of such a Definition"

1. Executive Summary

This is the second substantial parliamentary inquiry into section 51AC of the *Trade Practices Act* since it began operation just ten years ago. This is not because section 51AC has failed in its purpose but because sections of the 'small business lobby' have always insisted that the *Trade Practices Act* should prohibit 'unfair' or 'harsh' conduct rather than 'unconscionable' conduct. There are also parts of the 'small business lobby' that will never accept that no amount of additional regulation can shield small businesses from the adverse consequences of commercial risk-taking.

We believe section 51AC *has* achieved its purpose. The true test of a law is its success in changing behaviour. The success or otherwise of road safety laws, for example, is judged by the reduction in traffic accidents and deaths; not by the number of successful prosecutions for breaches of the law. In the area of retail leasing, to take one area, the Productivity Commission has recently noted: "*while there is a relatively limited case history pertaining to unconscionable conduct claims, threat of action under unconscionable conduct provisions appears to have had an influence on market conduct.*"

The relatively small number of unconscionable conduct cases brought before the courts is not an indication that section 51AC has failed. The number of prosecutions is the result of a range of factors: the small number of complaints actually made to the Australian Competition and Consumer Commission (itself an indication that the incidence of such behaviour has always been vastly exaggerated); the wide availability of alternative forms of relief under both the *Trade Practices Act* and other legislation; a better educated and better informed small business constituency; and a more heavily regulated market.

Discussion about section 51AC often proceeds as though it is the only avenue available for small businesses which are aggrieved. There are other sections of the *Trade Practices Act* (such as section 52 for misleading and deceptive conduct and section 53 for false and misleading representations) as well as, in the case of small retail tenants, the extensive regulatory protections contained in State and Territory retail tenancy legislation, which are constantly being reviewed and extended.

A previous Senate Committee in 2004 rejected arguments that section 51AC should also prohibit 'harsh' or 'unfair' conduct on the grounds that this would make the section "unworkably ambiguous" and that it was not clear that this change would enhance protections for small business. No persuasive arguments have been made since then to overturn this reasoning. Similarly, claims that section 51AC should be amended to introduce a notion of 'good faith' should be resisted since there is no clearly defined, well understood, statutory doctrine of 'good faith'.

There is no justification for further amending section 51AC at this time.

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2. What is the legislative purpose of section 51AC?

Part IVA of the *Trade Practices Act* addresses unconscionable conduct in three sections. Section 51AA is a broad prohibition on unconscionable conduct within the meaning of the law that has been developed by the courts. Section 51AB applies to transactions between business and consumers. Section 51AC applies to transactions between businesses in relation to the supply of goods or services. The notion of a statutory definition of unconscionable conduct can only apply to sections 51AB and 51AC. This submission concentrates on section 51AC.

Section 51AC was included in the *Trade Practices Act* in 1997 and began operation on 1 July 1998. It was introduced following a Report in May 1997 by the House of Representatives Standing Committee on Industry, Science and Technology '*Finding a balance: towards fair trading in Australia'* (commonly known as the Reid Report.) The then Federal Government considered, but rejected, incorporating a 'fairness' test into the Act; preferring instead to draw on, and expand, the unwritten law (equitable doctrine) of unconscionable conduct. The Government said section 51AC would *"provide a new avenue for small and specialist retailers to pursue remedies against unconscionable conduct in the retail tenancy relationship."*[1] In practice, however, section 51AC is broader in operation than just retail tenancy relationships.

In 2003-04 section 51AC was a major focus of inquiry by the Senate Economics References Committee in into 'the effectiveness of the *Trade Practices Act 1974* in protecting small business'. The Committee concluded that section 51AC was a relatively new section that had not yet had time to develop a significant body of jurisprudence. It did not accept arguments that the section was ineffective in protecting small business. The Committee specifically rejected calls to amend the section by adding the words 'harsh' or 'unfair' to the drafting of section 51AC. The Committee concluded that it is "*not clear that [the inclusion of either 'harsh' or 'unfair'] would enhance protection for small business under the Act, and as a result the Committee does not support their inclusion."*[2]

As a result of the Committee's report the then Federal Government decided to lift the ceiling on transactions caught by section 51AC from $3 million to $10 million and to add unilateral variations of contracts to the non-exhaustive list of factors which can be taken into account when determining unconscionable conduct. Legislation amending the *Trade Practices Act* to give effect to these decisions was finally passed in 2007. Further legislation completely removing the monetary threshold on unconscionable conduct claims was passed in 2008.

Most of the States and Territories have also now incorporated similar provisions to section 51AC in their retail tenancy legislation. This was done, according to these governments, to provide retail tenants with a lower cost and more easily accessible tribunal to deal with allegations of unconscionable conduct. The operation of these State and Territory provisions was made possible by the passing of the *Trade Practices Amendment (Operation of State and Territory Laws) Act 2001*. New South Wales, Queensland, Victoria, Western Australia and the Northern Territory have now all 'drawn down' section 51AC into their respective retail tenancy legislation

[1] *The Hon Peter Reith MP, Minister for Workplace Relations and Small Business, House of Representatives, 30 September 1997*

[2] *Report of the Senate Economics References Committee 'The effectiveness of the Trade Practices Act 1974 in protecting small business' March 2004 p.xv.*

Section 51AC was introduced to provide a new avenue for small businesses to pursue remedies against large businesses which were guilty of 'unconscionable' conduct. Section 51AC was not introduced, nor has it been amended, to address conduct which might subjectively be assessed as 'harsh' or 'unfair.'

3. Does section 51AC serve its intended purpose?

In Australia in *Louth v Diprose* (1992) 175 CLR 621 at 637, Deane J conveniently summarised the requirements of the unwritten law to obtain relief against unconscionable conduct as follows:

"(i) a party to a transaction was under a special disability in dealing with the other party to the transaction with the consequence that there was an absence of any reasonable degree of equality between them and (ii) that special disability was sufficiently evident to the other party to make it prima facie unfair or "unconscionable" that the other party procure, accept or retain the benefit of, the disadvantaged party's assent to the impugned transaction in the circumstances in which he or she procured or accepted it.

In terms of what constitutes a special disability the definitive statement of the law is that of Fullagher J in Bromley v Ryan as follows:

"The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-à-vis the other."

In equity (and in section 51AA) something more "special" is required than merely taking advantage of a superior bargaining position: *ACCC v CG Berbatis Holdings Pty Ltd [2003] HCA 18; (2003) 214 CLR 51; 77 ALJR 926; 197 ALR 153; ATPR 41-916*

By contrast it is now generally accepted that the term "unconscionable" in section 51AC is to be interpreted more broadly than the interpretation developed by the courts of equity: *ASIC v National Exchange Pty Ltd [2005] FCAFC 226; (2005) 148 FCR 132*; *ACCC v CG Berbatis Holdings Pty Ltd [2000] FCA 1376 per French J*; *Auto Masters Australia Pty Ltd v Bruness Pty Ltd [2002] WASC 286; (2003) ATPR 46-229 per Hasluck J.*

In particular, given that the legislative aim of section 51AC was to provide small business with effective remedies against unconscionable conduct in their dealings with "big business," and that there is specific reference in section 51AC(3) to "the relative strengths of the bargaining positions of the supplier and the business consumer", it is accepted that large businesses might now be caught by section 51AC not only when dealing with someone under an inherent disadvantage because of something personal such as lack of education, drunkenness or illness (as covered by the equitable doctrine) but also when dealing with someone in a weaker commercial position, including smaller businesses.

Further, there have been a number of successful ACCC actions, such as *ACCC v Simply No-Knead (Franchising) Pty Ltd* and *Automasters Australia Pty Ltd v Bruness Pty Ltd, (2003) ATPR (Digewst) 46-229* which have provided significant guidance as to what is unacceptable behaviour.

Section 51AC in the Trade Practices Act (and in other relevant legislation, into which it has been drawn down) does serve its purpose of providing an extended avenue for small businesses to pursue remedies against large businesses guilty of 'unconscionable conduct'.

4. Is the relatively small number of section 51AC legal actions evidence that the section is ineffective?

The assumption underlying the present inquiry seems to be that section 51AC needs to be amended because it has been ineffective. Unfortunately there was no debate on Senator Xenophon's motion[3], simply an unchallenged assertion by Associate Professor Frank Zumbo, cited by Senator Xenophon, that "*unless you change the substantive meaning or the substantive flaws in 51AC as they currently exist – that is, a lack of definition of unconscionable conduct in the section itself – removing the [monetary thresholds on actions] will not be of any practical assistance."*

Some small business groups have argued that the relatively few successful prosecutions for unconscionable conduct is evidence either that the ACCC has been lax in its administration of section 51AC or that section 51AC has been ineffective in controlling unconscionable conduct. Neither assertion is true.

The ACCC has recently reported[4] that, since July 1998, it has litigated 15 actions for breaches of section 51AC and it has since announced the lodgement of another action. Contrary to claims that these prosecutions have generally been unsuccessful, thirteen of these actions were either successful in the courts or were settled by consent and only two were unsuccessful. This is not evidence that the ACCC is having difficulty in bringing successful prosecutions. The ACCC has also reported that "at least 90 private actions pleading section 51AC were brought before various courts" between 1998 and November 2007[5].

The ACCC has also reported that around 26% of these cases related to allegations of unconscionable conduct in the retail tenancy sector and to other tenancy situations. "*These cases were successful in educating the landlords and tenants of their rights and obligations under the TPA and have assisted in clarifying the concept of unconscionable conduct in the retail tenancy context."*[6]

While 16 actions by the ACCC in 10 years might not seem many, this has to be considered in the context of the relatively few complaints of unconscionable conduct actually received by the ACCC. In the five years between 1 July 2002 and 30 June 2007, for example, the ACCC received only 179 'complaints' relating to retail tenancy issues[7] (i.e. situations where a breach of the *Trade Practices Act* was alleged by the complainant or where the conduct described was identified by the ACCC as a possible contravention of the Act.) This is an average of only 36 complaints a year.

To provide some context for this number of retail tenancy complaints it should be noted that the Productivity Commission has estimated that there are around 290,000 retail tenancy leases in Australia.[8] This means only 0.012% of retail leases each year

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[3] *Senator Xenophon (South Australia) Senate 16 September 2008 p.2*

[4] *ACCC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Franchising Code of Conduct September 2008 p.15*

[5] *ibid p.16*

[6] *ACCC Submission to the Productivity Commission Inquiry into the Market for Retail Tenancy Leases in Australia. Revised 25 September 2007 pp 32-33.*

[7] *ibid. p.27*

[8] *Productivity Commission Inquiry Report No. 43, 31 March 2008, p.14.*

results in a complaint to the ACCC. In other words, only around 12 leases in every 100,000 results in a complaint to the ACCC alleging a breach of the Trade Practices Act. It should also be remembered that a retail lease is not a one-off transaction (like a consumer purchase) but remains on foot seven days a week, 52 weeks a year.

Incidentally this very small number of complaints of unconscionable conduct involving the retail tenancies has occurred despite the ACCC, as part of its functions, conducting comprehensive publicity and education campaigns to make small businesses, and small retailers in particular, aware of the provisions of section 51AC. The ACCC has also had, at various stages, special funding and even a ministerial direction to mount test cases under the section.

The ACCC further reported that, of these 179 complaints in five years, 108 were immediately assessed as not amounting to a breach of the Act. Of the remaining 71, 35 were found to have insufficient evidence; 13 were referred to other agencies; 10 involved the ACCC giving information or guidance; 3 involved an administrative resolution; 2 were not pursued because the complainant was already taking legal action; and 8 were still under active investigation[9].

The ACCC's submission to the Productivity Commission also gives detailed information[10] on the procedures it adopts in investigating the complaints made to the Commission. It can be seen from this explanation that there is no justification for assertions that the ACCC has been lax in its oversight of section 51AC. As the former chairman of the ACCC, Professor Allan Fels, said: ". . . *the ministerial direction [to bring test cases] does not force the commission to run a section 51AC test case to conclusion even though it could be better settled administratively. Nor does it require a case with little merit to be run by the commission. This would be totally against the commission's method of operation. We do wish to clarify the law and will do so where the facts have legal merit and a positive outcome may be achieved by litigation."*[11]

The ACCC is not the only body responsible for enforcing unconscionable conduct laws in business-to-business relationships. As noted in section 2 of this submission, the provisions of section 51AC have now been 'drawn down' into retail tenancy legislation in NSW, Queensland, Victoria, Western Australia and the Northern Territory and there are similar provisions in the ACT and Tasmania. However it is difficult to gain a clear picture of the number of unconscionable conduct cases in these jurisdictions because of the absence of detailed public reporting.

One jurisdiction which does provide data is NSW. If we examine applications to the NSW Administrative Decisions Tribunal we find that the incidence of unconscionable conduct complaints is also very low. The picture is somewhat confused by the tendency of many applicants and solicitors to 'tick all boxes' when lodging retail tenancy dispute claims – thus 65 of the 184 applications filed with the ADT in 2005-06[12] (i.e. 35%) were both ordinary retail tenancy claims and unconscionable conduct claims. Those alleging unconscionable conduct only, however, numbered only 4 (i.e. 2.2% of all applications.) Even if we assume that half of those applicants that 'ticked all boxes' actually alleged an element of unconscionable conduct, this would still mean that only 0.04% of all retail leases in NSW result in an allegation – not evidence, it is important to note, but an allegation – of unconscionable conduct. In other words, despite the NSW ADT having had the power to determine

[9] *ACCC Submission op. cit. p.27*
[10] *ibid. pp. 24-30*
[11] *ACCC media release 9 July 1999. Emphasis added by ACCC.*
[12] *Annual Report of the NSW Administrative Decisions Tribunal 2005-06 p.47*

unconscionable conduct cases in retail leasing since October 2001, the tribunal has not been inundated with allegations of unconscionable conduct. Nor is there any evidence from the ADT's annual report that the tribunal is having difficulty hearing complaints involving unconscionable conduct.

The relatively small number of section 51AC actions is a direct consequence of the very small number of complaints made of unconscionable conduct. It is not evidence of section 51AC unconscionable conduct cases being too hard to prove nor that the section is ineffective as a remedy to such conduct.

5. Is the relatively small number of section 51AC legal actions evidence that other legislation and measures introduced to protect small businesses working effectively?

We must admit to frustration that so much discussion of section 51AC, particularly academic discussion, proceeds as though the section operates in a vacuum and that it is the only recourse for small businesses which are aggrieved. This is not the case.

In the *Trade Practices Act* itself, section 52 provides effective relief where the conduct of the parties is "misleading and deceptive". Misleading and deceptive conduct might often be equally described as unconscionable conduct (particularly if it is intentional.)

As the ACCC said in its submission to the Productivity Commission[13]:*"…[Unconscionable conduct] generally presents as a complex web of interlinking accusations and claims (i.e. misleading and deceptive conduct, harassment and coercion, misrepresentations) and personal grievances that require intensive, time consuming investigations to untangle the legally relevant facts."*

For the reasons detailed below affected parties often prefer to rely on section 52, which is more prescriptive, than section 51AC. We consequently see, and would expect to see, fewer section 51AC cases than cases under section 52.

Further, in terms of the retail tenancy market, there is throughout Australia extensive State and Territory legislation regulating retail leases. Five of the six States and the two Territories have specific legislation regulating the retail tenancy relationship. (Tasmania regulates retail tenancies by a code of practice adopted by regulation under the Fair Trading Act.) The relevant legislation is:

- *Retail Leases Act 1994 (NSW)*
- *Retail Leases Act 2003 (Victoria)*
- *Retail Shop Leases Act 1994 (Queensland)*
- *Retail and Commercial Leases Act 1995 (SA)*
- *Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA)*
- *Leases (Commercial and Retail) Act 2001 (ACT)*
- *Business Tenancies (Fair Dealings) Act 2003 (NT)*

[13] *ACCC Submission to the Productivity Commission Inquiry, op.cit.p.30*

- *Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998 (Tasmania)*

This legislation, in all States and Territories, is very detailed and prescriptive as to what constitutes acceptable behaviour by retail property owners and managers in transactions with their tenants. It regulates all aspects of the retail tenancy relationship and provides protection for retail tenants even before they have signed a lease. It also provides mechanisms to resolve retail tenancy disputes by easily accessible and low-cost mediation and, only if mediation fails, allows either party to refer the matter to experienced retail tenancy tribunals for a prompt and efficient determination.

We are unaware of any other country in the world which has such a highly regulated retail tenancy market as Australia. New Zealand, for example, does not have specific retail tenancy legislation.

The additional disclosure of information by landlords to tenants, required by State and Territory retail tenancy legislation, has significantly reduced the instances of market conduct which might be construed as unconscionable. Further, where complaints have arisen, the complainants invariably rely on more prescriptive and easily established causes of action found in retail tenancy legislation, rather than relying on section 51AC, which makes sense having regard to costs and time. In retail leasing, in particular, section 51AC is treated as a 'catch all' provision, which has regard to all the circumstances, covering areas where the more prescriptive (and more easily proved) legislation is deficient.

As a 'catch all' provision the strength and effectiveness of section 51AC, like Part IVA of the *Income Tax Act*, is its breadth and the fact that, as the Court stated in *Babcroft Pty Ltd v Goebel Pty Ltd*, the doctrine of unconscionable conduct resembles an elephant in that it "is impossible of simple or exhaustive definition [but] is nevertheless easily recognisable when presenting itself."

This strength of section 51AC – that it takes into account all the circumstances – is also the reason that it tends to operate as a law of last resort. Establishing "all the circumstances" can be expensive. Well advised litigants typically choose more prescriptive, albeit more limited, causes of action where available.

In the franchising industry the conduct of franchisors and franchisees is now governed by the *Franchising Code of Conduct* which, like retail tenancy legislation, sets out an established body of rules as to what constitutes acceptable behaviour by franchisors in dealings with franchisees. The Code also provides a cost-effective dispute resolution scheme for franchisees and franchisors. Franchisees also prefer to rely on the Code rather than action under section 51AC where it provides comparable relief.

It is sometimes claimed that bringing an unconscionable conduct action is too difficult and that plaintiffs instead 'fall back' on other courses of action, such as section 52 relating to misleading and deceptive conduct. In accordance with good legal practice it is not surprising, and is to be encouraged, that legal practitioners (and the Courts) are first relying on other causes of action and using unconscionable conduct as a 'catch all' where the particular conduct does not readily fall within one of these more easily defined and limited causes of action. This is the 'supplementary' role that section 51AC was intended to play and should play.

The relatively small number of section 51AC legal actions is evidence that other legislation, including retail tenancy legislation and the Franchising Code, as well as section 52 of the Trade Practices Act, are working effectively to protect small businesses where appropriate to do so. Section 51AC is continuing to serve the supplementary role that it was intended to play when necessary.

6. Has section 51AC changed industry behaviour?

The true test of any law is its success in changing behaviour. We judge the success or otherwise of road safety laws by the reduction in the number of traffic accidents and deaths; not by the number of successful prosecutions for breaches of those laws. It is strange, therefore, that small business groups and some academic commentators insist on measuring the success of section 51AC on the number of 'scalps' hanging from the ACCC's belt; not on whether it has brought about a change in industry behaviour.

It is our experience that major shopping centre owners and managers, for example, now devote significant resources to education and compliance courses for their staff in order to ensure they are aware of their legal and ethical obligations in dealing with tenants, franchisees and other parties. No reputable shopping centre owner or manager wants to be accused of acting unconscionably or to be found to have acted unconscionably. Such a finding would have wider commercial ramifications, as well as the liability flowing from the particular action.

Consistent with our experience in the area of retail leasing the Productivity Commission has recently concluded: "*While the unconscionable conduct provisions set a high bar, there is also a significant incentive to settle an accusation of unconscionable conduct before it proceeds to court – just because the case history is limited does not mean that the provisions are not influencing business conduct."*[14]

The Productivity Commission has also noted that "*while there is a relatively limited case history pertaining to unconscionable conduct claims, threat of action under unconscionable conduct provisions appears to have had an influence on market conduct."* [15]

In our view there is no doubt that section 51AC has contributed to a change in behaviour in key industries including retail leasing.

7. Should a statutory definition of unconscionable conduct be introduced?

Associate Professor Frank Zumbo, who was the only authority cited by Senator Xenophon in initiating this inquiry[16], has asserted that the insertion of a statutory definition of unconscionable conduct will: *"send a clear parliamentary signal to the Courts that the concept is not only broader than the equitable concept, but that section 51 AC is intended to promote ethical business conduct. Such a definition would set out a non-exhaustive benchmark for assessing conduct to determine whether or not it goes beyond what is reasonably necessary to protect the legitimate interests of the parties involved. This would not in any way interfere with the driving*

[14] *Productivity Commission Inquiry into the Market for Retail Leases in Australia, Report No. 43, 31 March 2008 p.188*
[15] *Productivity Commission Inquiry into the Market for Retail Leases in Australia Draft Report p.178*
[16] *Senator Xenophon, op. cit. p.2*

of a "hard" bargain, but rather would provide clear statutory guidance as to what is considered unethical."[17]

Professor Zumbo has further suggested the following definition should be inserted in the Trade Practices Act: "*For the purposes of this section 'unconscionable conduct' includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience*".[18]

This is simply a variation on arguments previously made by the 'small business lobby' in 2003-04 to the Senate Economics References Committee which examined the effectiveness of the *Trade Practices Act 1974* in protecting small business. The Fair Trading Coalition on that occasion sought to prohibit 'harsh' and 'unfair' conduct, as well as 'unconscionable' conduct, in section 51AC. This was rejected by the Committee.

In relation to the inclusion of a prohibition on 'harsh' conduct the Senate Economics References Committee "*noted the dictionary definition of harsh as 'repugnant or roughly offensive to the feelings; severe, rigorous, cruel, rude, rough, unfeeling' and came to the view that a business's behaviour may be any of these without being anticompetitive. Indeed, a certain amount of harsh behaviour may well be necessary for competitive success."*[19]

The Committee also concluded that "*introducing a concept of 'unfairness' to section 51AC carries a serious risk of making the section unworkably ambiguous, by calling on concepts with an unclear legal meaning. It is not clear that 'unfair' would represent a lesser test than 'unconscionable' or that such a provision would enhance protection for small business.*"[20]

Government Senators on the Committee supported the recommendation not to introduce these concepts into section 51AC. They added: "*It is our belief that the consequence of [introducing "vague new statutory language into section 51AC"] would make the meaning of the section so open to a variety of different interpretations that it would be inimical to the development of a coherent and relatively clear body of law. Furthermore the transactional uncertainty which the introduction of such language would produce would have undesirable consequences for commerce, the social cost of which is difficult to assess. Paradoxically, it is likely to be the very persons whom the section is designed to protect (i.e. persons in position of relative weakness in a transaction) who would suffer most from such transactional uncertainty."*[21]

We agree with the findings of the Senate Committee in 2004 that these concepts are unworkable in business-to-business transactions and provide no meaningful guidance as to how business is to act in a particular transaction with another business. Commercial parties want laws that, in any given situation, ensure both parties [seeking legal advice as to their rights and obligations] can expect the same clear and confident answer from their advisers. Those laws should ensure that neither party will be tempted to embark on long and expensive litigation in the belief that victory depends on winning the sympathy of the court, or the lottery of which judge or arbitrator may be sitting on the bench or the tribunal.

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[17] *Frank Zumbo, Submission to the SA Inquiry into Franchises, February 2008, p. 13*
[18] *ibid p.13*
[19] *Report, op.cit. p.34*
[20] *ibid. p.36*
[21] *ibid. p.85*

As one commentator has said: *"Most people would agree that it is undesirable for judges to decide that business conduct is unconscionable simply by reference to idiosyncratic or personalised notions of fairness and justice unguided by law, as some kind of misguided "individualised justice", "discretionary remedialism", or abandonment of "principle" for "pragmatism"."*[22]

It is for the above reasons that, following the Reid Committee report in 1997, the Australian Government settled on an unconscionability standard rather than an unfairness standard when determining whether business conduct breached the *Trade Practices Act*. That reasoning was upheld by the Senate Committee in 2004. No persuasive arguments have been made since then to cause that reasoning to be overturned.

The Productivity Commission has also recently considered the arguments for expanding the concept of unconscionable conduct in the area of retail tenancies. The Commission noted: "*In business transactions, a 'hard bargain' does not necessarily constitute unconscionable conduct. . . Attempting to legislate what constitutes a 'fair transaction', and what does not, is inherently difficult and is likely to add further uncertainty to the meaning of unconscionability and potentially constrain the efficient operation of the market as returns to superior bargaining skills are eroded, costs of disputation are increased and the efficiency of investment is diminished by increased uncertainty."*[23]

The Productivity Commission also noted it was possible that introducing regulations relating to 'fairness' in business-to-business transactions could lead to 'moral hazard'. "*Businesses would be afforded greater protection when undertaking negotiations or in a business transaction, increasing the likelihood of bad decision making through the reduced negative consequences of such decisions. In the Commission's assessment, extending the principle of unconscionable conduct is likely to place constraints on the efficient operation of the market and should be avoided."*[24]

The Commission also noted that it had *"received no compelling evidence during the inquiry [into the market for retail tenancy leases in Australia] from those advocating extending the provisions of unconscionable conduct that such an approach would be effective in reducing market tensions and the cost of contracting."*[25] It should be noted that Associate Professor Zumbo was one of those advocating such an approach in a submission to the Productivity Commission and in a personal appearance at one of the Commission's public hearings.

The *Review of the Competition Provisions of the Trade Practices Act* in 2002 (the Dawson Review) did not specifically examine section 51AC, finding that Part IVA lay outside its terms of reference. The Review did, however, recommend that the ACCC "*should give consideration to issuing guidelines on its approach to Part IVA"*[26] and this recommendation was supported by the Federal Government. The ACCC has since issued two useful publications: '*Guide to unconscionable conduct'* (the latest version was published in May 2008) and '*A small business guide to unconscionable conduct'* (published in 2005.)

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[22] *The expansion of fairness-based business regulation – unconscionability, good faith and the law's informed conscience by Bryan Horrigan (2004) 32 ALBR 159*

[23] *Report, op.cit. p212*

[24] *ibid. p.212*

[25] *ibid. p.212*

[26] *Review of the Competition Provisions of the Trade Practices Act January 2003 Recommendation 3.2 p.12*

The statutory definitions of unconscionable conduct that have been proposed for inclusion in the Act are in reality no more than attempts to redefine unconscionable conduct as 'unfair' or 'harsh' or 'unreasonable' conduct. For the reasons given by the Senate Committee in 2004, and by the Productivity Commission in 2008, these attempts to redefine what is unconscionable conduct should be rejected. Rather continued efforts should be made to promote and encourage the use of information guides published by the ACCC.

6. Should a list of conduct ordinarily considered unconscionable be included in the Trade Practices Act?

Associate Professor Zumbo has also proposed, as an alternative to inserting a statutory definition of 'unconscionable conduct', "to recast the existing list of factors under section 51AC(3) and 51AC(4) to represent examples of conduct that would ordinarily be considered to be 'unconscionable.'[27]

At present section 51AC(3) states: "*Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation or a person (the **supplier**) has contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the **business consumer**), the Court may have regard to:. . .* ". Professor Zumbo has proposed this be recast as follows: "*Without in any way limiting the conduct that the Court may find to have contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the business consumer) the following will, in the absence of evidence to the contrary, be regarded as unconscionable for the purposes of subsection (1) and (2): . . .*"[28] (Professor Zumbo slightly redrafts the existing items (a) to (l) to accord with his revised wording.)

This would immediately put a straightjacket on section 51AC. It also has the potential to limit the application of the meaning of 'unconscionable conduct'. Professor Zumbo effectively concedes this when he says, in justification of his proposal: "*Currently the Courts are left to their own devices as to the meaning of 'unconscionable' under section 51AC and this brings with it the real danger that the Courts will revert to the more narrow equitable notion of unconscionability when assessing conduct under the section. By setting out statutory benchmarks in the section itself the legislature can provide clear direction to the Courts regarding the types of conduct ordinarily considered to be unethical by the legislature. Such benchmarks would seek to steer judicial attention away from the narrow equitable notion of unconscionability and towards having the Courts assess the conduct by reference to the ethical norms set out by the legislature in its statutory lists of examples*."[29]

At present the courts will determine whether a business has acted unconscionably by considering *all* the circumstances of the dispute. "*Each of [the factors listed in paragraphs (a) to (l)] in isolation may not amount to unconscionable conduct, but may do so when considered cumulatively and evaluated in the light of all the circumstances.*"[30] In other words these factors are not in themselves unconscionable but simply factors the courts may take into account in deciding whether the supplier's behaviour was unconscionable. Under Professor Zumbo's formulation these

[27] *Frank Zumbo, Submission to SA Franchises Inquiry, p.14*
[28] *ibid pp.14-15*
[29] *ibid p.15*
[30] *Australian Competition and Consumer Commission 'Guide to unconscionable conduct' May 2008 p.5*

factors have been elevated to “ethical norms” or “conduct ordinarily considered to be unethical.”

This could have absurd consequences in commerce and this can be shown by taking an example from our industry. Many shopping centre tenants currently renewing leases in shopping centres would be seeking ‘incentives’ from the landlord as part of the bargaining process. It is not unusual, for example, when trading conditions are unfavourable, for a lessor to pay all or a substantial proportion of the cost of the new fit-out of the shop required under the lease. It is likely that, with the outlook for retail sales growth much less optimistic than it was 12 months ago, such an ‘incentive’ will again become fairly common in lease negotiations and renegotiations. One of the factors the courts are presently required to consider in deciding whether conduct is unconscionable is “*the extent to which the stronger party’s conduct was consistent in similar transactions with other similar businesses.”*

Consider the case of a tenant who may have renewed their lease 12 months ago, when retail sales were still very strong and the economic outlook propitious, who has now fallen into dispute with the landlord. Such a tenant might argue that the current renewal of a lease of a direct competitor, which included such an incentive, was discriminatory and indeed unconscionable. A court would take into account all the circumstances of the case, including the trading history of the respective tenants and the differences in economic outlook at the time of renewal, in making a decision about such a claim. As the ACCC has noted “*one business may simply have been able to negotiate a better deal than another similar business. The existence of such an inequality will not, of itself, give rise to unconscionable conduct*.”[31] Under Professor Zumbo’s formulation however, this would be an example where “the supplier’s conduct towards the business consumer was significantly inconsistent with the supplier’s conduct in similar transactions between the supplier and other like business consumers.” This would be, according to Professor Zumbo, “*conduct ordinarily considered to be unethical*.” The consequence of this would be the elimination of such ‘incentives’, hardly a policy outcome that a sensible legislature would be seeking to achieve.

A statutory list of conduct ordinarily considered unconscionable conduct should not be inserted in section 51AC.

7. Should the requirement for unconscionable conduct be replaced by, or supplemented with, a statutory duty of good faith?

Associate Professor Zumbo’s proposed statutory definition also includes a statutory duty of ‘good faith’. In recent submissions he has claimed: *"Clearly, the concept of good faith has not only received strong judicial support, but now has reached a point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could readily and usefully draw upon in seeking to promote ethical business conduct."*[32]

Other commentators have also argued that ‘good faith’ is an appropriate, sufficiently certain, legal test:

- *"The doctrine of good faith has been present in the Australian law for some time … over recent years the Australian judiciary, especially in New South*

[31] *ibid. p.7*

[32] *Frank Zumbo, Submission to SA Franchises Inquiry, op. cit., p. 17. See also his submission the Productivity Commission inquiry into the market for retail tenancy leases in Australia, No. DR200 p.16*

Wales and Victoria, have recognised the existence of the duty of good faith and fair dealing as an implied term in franchise contracts."[33]

- *"…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."*[34]

The Committee should be very cautious in relying on such statements. The truth is that an overriding duty of good faith is impossible to define and would add unnecessary uncertainty to already complex business-to-business relationships. Nor is it correct to assert, as Professor Zumbo has, that the "*nature and scope [of the concept of good faith] is being defined with an increasing degree of precision."*

Respected academics, legal practitioners and judges have expressed very different views about the status of any duty of good faith. Certainly Professor Zumbo's opinion that good faith is well accepted, and has been defined with some precision, is contrary to the opinion of many qualified legal experts. We have cited below just some of these views:

- *"To say that the role of good faith in Australian contract law is currently unsettled and that the law is in a state of flux would be an understatement. It may be closer to the mark to say that it is in a state of utter confusion."*[35]

- *"Despite the increased use of implied and express terms of 'good faith' in contracts over the last 10 years, there is still little agreement about the exact meaning of the obligation."*[36]

- *"There is no uniformly agreed definition of 'good faith'*[37]*.*

- *"The recognition of good faith as a principle inherent in contractual relationships has caused sufficient judicial angst for its place to continue to be doubted within Anglo-Australian jurisprudence."*[38]

- *"Perhaps the most important unresolved issue in Australian contract law today is the extent to which the law recognises an implied requirement of good faith in performance and enforcement."* [39]

- *"One of the stumbling blocks is that Australian law has yet to come to terms with the concept of good faith. Firstly, it is difficult to compose a workable definition and secondly there is the issue of the standard of conduct which will amount to a breach of a duty of good faith, or simply bad faith."*[40]

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[33] *Robert McDougall, "The Implied duty of good Faith in Australian Contract Law", Australian Contract Law, Supreme Court of New South Wales, at http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_mcdougall210206 (accessed on 7 April 2008) as cited in SA Franchises Report at 54*

[34] *Final Report Franchises Sixty-Fifth Report of the Economics and Finance Committee, SA Parliament p. 55*

[35] *Good Faith in Australian Contract Law by JW Carter and Elisabeth Peden*

[36] *The meaning of contractual 'good faith' by Dr Elisabeth Peden*

[37] *See eg Aiton Australia Pty Ltd v Transfield Pty Ltd (2000) 16 BCL 70 at [156] per Einstein J; R Brownsword*

[38] *Too Much Concern Too Soon? Rationalising the Elements of Section 51AC of the Trade Practices Act by Philip Tucker*

[39] *Interpretation, Good Faith and the 'True Meaning' of Contracts: The Royal Botanic Decision by JW Carter and Andrew Stewart.*

[40] *Outline of the Interaction of Retail Tenancy Issues and Section 51AC*

Even those academics, practitioners and judges who advocate that there exists, or should exist, general overriding duties of good faith, are unable to agree, even generally, as to its content. They variously and vaguely suggest:

- *"The proposition that a requirement, perhaps even a duty, of 'good faith and fair dealing' should be recognised as an inherent feature of contracts is now routinely accepted … These cases have not, however, given much content to the requirement, or even explained whether it operates as an obligation the breach of which sounds in damages."* [41]

- *"There is no uniformly agreed definition of 'good faith'*[42]*.*

- *"In most instances, the good faith requirement envisaged in the Australian cases seems to equate with the established principles that a party must act honestly, and do 'all such things as are necessary … to enable the other party to have the benefit of the contract'."* [43]

- *"This article proposes that the most appropriate meaning of 'good faith' is a requirement that regard be had of the other party's interests. This definition includes 'loyalty' to the contract and subjective honesty. However, this definition does not go so far as to require 'reasonableness' or 'unconscionability', which have been suggested as concurrent obligations with 'good faith' in some cases."* [44]

- *"'[G]ood faith' embraces three notions: an obligation on the parties to cooperate in achieving the contractual objects (loyalty to the promise itself); compliance with honest standards of conduct; and compliance with standards of conduct which are reasonable having regard to the interests of the parties."* [45]

- *"… The duty is not a duty to prefer the interests of the other contracting party. It is, rather, a duty 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."* [46]

- *"Good faith operates to restrict a party exercising a discretion in a way that falls outside the justified expectations of the parties at the time of formation."* [47]

- *"Good faith demands that the latter party in this example not perform its obligations at less than the reasonably expected standard having regard to the parties' intentions (and the parties' corresponding reasonable and legitimate expectations) when the contract was formed, and to the subject matter of the contract."* [48]

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[41] *Interpretation, Good Faith and the 'True Meaning' of Contracts: The Royal Botanic Decision by JW Carter and Andrew Stewart.*
[42] *See eg Aiton Australia Pty Ltd v Transfield Pty Ltd (2000) 16 BCL 70 at [156] per Einstein J; R Brownsword*
[43] *Interpretation, Good Faith and the 'True Meaning' of Contracts: The Royal Botanic Decision by JW Carter and Andrew Stewart.*
[44] *The meaning of contractual 'good faith' by Dr Elisabeth Peden*
[45] *Sir Anthony Mason*
[46] *The meaning of contractual 'good faith' by Dr Elisabeth Peden*
[47] *The meaning of contractual 'good faith' by Dr Elisabeth Peden*
[48] *Too Much Concern Too Soon? Rationalising the Elements of Section 51AC of the Trade Practices Act by Philip Tucker*

The SCCA's legal advisers have reviewed the key authorities on 'good faith' and have concluded that 'good faith' takes on different meanings depending on its context.[49] In their view this is neither surprising nor unsatisfactory given that it is really a principle or policy deriving from and guiding the implication of terms and/or the construction of existing terms rather than being itself a legal norm.

In the view of our legal advisers the exact content of any implied obligation of good faith depends on the type of contract, the factual matrix, the parties involved and so on.[50] An obligation of good faith cannot stand on its own. There must first be an agreement with an objectively ascertainable common purpose(s) with respect to which the parties must be able to be 'faithful'. It makes no sense to simply say that parties must perform in good faith. Rather "[w]e must know what terms they will be performing. If we are then requiring those terms to be performed in good faith, really all we are doing is explaining the standard to which they must perform."[51] In this way the obligation of good faith fills in the gaps.

(We have included in the **Appendix** a more detailed exploration of the doctrine of 'good faith' by our legal advisers.)

A review of the key authorities reveals that there is no overriding duty of good faith in equity or common law. Rather "good faith", "reasonableness" and similar terms are concepts which are, as a matter of construction or by construction, used to fill in the gaps of contractual provisions but only where it is not inconsistent with the express provisions to do so. This ensures the sanctity of contract. Where there is a fixed term lease which expires on a certain date there is no gap to fill and therefore no common purpose in respect of which 'good faith' may operate.

Having regard to the above the Committee should appreciate that when Associate Professor Zumbo describes 'good faith' as something different, and suggests that the concept "would be one way to make explicit the underlying ethical standards of the industry as a whole", he is really talking about 'fairness' – a principle he has long championed[52] as a legal norm. He is attempting to cloak 'fairness' under the guise of 'good faith' - to suggest it is respectable, legitimate and accepted as a judiciable legal norm.

An overriding duty of 'good faith', like 'fairness', is impossible to define and would add unnecessary uncertainty to already complex business-to-business relationships. An overriding duty of 'good faith' is not well accepted nor precisely understood at common law. The Courts, in the course of implying and construing commercial terms, from time to time have regard to principles such as 'good faith', 'reasonableness', 'fairness' and so on. The exact content of any obligation implied or construed by reference to 'good faith' depends on the type of contract, contractual context, the factual matrix, the parties involved and so on. Such an 'obligation of good faith' cannot stand on its own and is not suitable for supplanting as a statutory duty.

An overriding duty of good faith is impossible to define, is not well accepted or precisely understood at common law and should not be inserted in the Trade Practices Act.

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[49] See eg Aiton Australia Pty Ltd v Transfield Pty Ltd (2000) 16 BCL 70 at [156] per Einstein J; R Brownsword
[50] The meaning of contractual 'good faith' by Dr Elisabeth Peden
[51] Contracts: Good faith in the performance of contract law by Dr Elisabeth Peden
[52] See submission to Reid Committee in 1997.

8. Changes to collective bargaining procedures

There is another reason why the Senate Committee should be sceptical of claims made to this inquiry that section 51AC is not working. There have been previous instances where claims by the 'small business lobby' have been taken at face value, only to find subsequently that those claims had no validity. In submissions to the Dawson Review, for example, small business organisations argued that the reason why small businesses did not bargain collectively in dealings with big business was because the authorisation processes for collective bargaining by small businesses in the *Trade Practices Act* were too lengthy, too cumbersome and too costly.[53] They argued that special procedures should apply to small businesses to enable them to bargain collectively without being in breach of provisions of the Act.

In its report the Dawson Committee accepted these arguments and recommended "*a notification process should be provided to assist small business, including co-operatives which meet the definition of small business, in dealing collectively with large businesses where the collective bargaining may generate public benefit.*"[54] In turn the Federal Government committed itself to introducing a notification process that would be "*speedier and simpler for small business than existing processes*." It also agreed that "*to ensure that costs are kept to a minimum for small businesses, the notification fee is to be set at an appropriately low level.*"[55]

Legislation amending the Trade Practices to give effect to this undertaking was passed in 2006 and the new collective bargaining procedures began operation on 1 January 2007. The ACCC deployed considerable additional staff resources to ensure that the necessary public interest consideration could be given to collective bargaining notifications within the limited period provided (14 days, but extended temporarily by regulation to 28 days). The ACCC also embarked on an extensive and expensive advertising program to inform small businesses of the new procedures. The ACCC Chairman, Mr Graeme Samuel, also used numerous speeches and media interviews exhorting small businesses to take advantage of the notification processes.

Despite the substantial public resources devoted to this change in procedures the ACCC has advised that only six collective bargaining notifications were made in 2007, the first full-year of operation of the new procedures. A search of the 'collective bargaining notifications register' on the ACCC's website at the end of September 2008 shows that only one notification had been made and finalised in the first nine months of 2008.

This substantial change in public policy, at a significant cost to taxpayers, was simply based on assertions by 'the small business lobby' that were never properly tested. Mr Samuel has said his experience now is that small businesses generally prefer to negotiate individually rather than collectively because they believe they will get a better deal that way. This experience is relevant to the current matter before this Senate Committee.

There is obviously need for greater public scrutiny of assertions by small business organisations, and their academic advisers, that sections of the Trade Practices Act are not working.

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[53] *See submission by Fair Trading Coalition July 2002 pp. 23-27.*

[54] *Report of the Review of the Competition Provisions of the Trade Practices Act January 2003 Chapter 7.*

[55] *Media statement by the Treasurer, Peter Costello MP, 16 April 2003.*

9. Contact

The Shopping Centre Council of Australia represents owners and managers of shopping centres. Our members are AMP Capital Investors, Brookfield Multiplex, Centro Properties Group, Colonial First State Property, Dexus Property Group, Eureka Funds Management, GPT Group, ISPT, Jen Retail Properties, Jones Lang LaSalle, Lend Lease Retail, Macquarie CountryWide Trust, McConaghy Group, McConaghy Properties, Mirvac, Perron Group, Precision Group, QIC, Savills, Stockland, Westfield Group and the Yu Feng Group.

We would be happy to discuss any aspect of this submission. Please do not hesitate to contact:

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APPENDIX

In Australia there is considerable debate whether the Courts that have implied a duty of good faith have in fact got it right. For instance, it has been said:

- *"… in Burger King Corp v Hungry Jack's Pty Ltd, the NSW Court of Appeal repeatedly referred to terms of 'good faith and reasonableness' … With respect, to equate an obligation of reasonableness and one of good faith is misconceived."* [56]

- *" it has been suggested that good faith may not only require honesty and a degree of co-operation, but extend beyond that to require compliance with a standard of 'reasonable' conduct. There are, potentially, two errors in this approach. "…once the parties are subjected to a general requirement of reasonableness in their performance and enforcement, virtually every aspect of that performance and enforcement is open to challenge. The reason for that is not hard to find. When viewed objectively, particularly with the benefit of hindsight, there will often look to be an element of unreasonableness (from one party's perspective) in the operation of a contract. But this is not in itself a sufficient basis for depriving a party of its contractual rights. This is an issue which those who consider that good faith should be implied as a matter of law into contracts of all description, or at least commercial contracts, must address. So far they have failed to do so."* [57]

In what the SCCA believes to be an independent "text" Halbury's Laws of Australia it is stated:

- *"As the law currently stands, there is no general contractual term, implied in law, requiring parties to act in good faith when negotiating a contract or in its performance. However, in some cases it has been made as a matter of law. Moreover, where a duty of good faith is implied, the duty may or may not be a term of the contract.*

- *Nevertheless, a duty to act in good faith may be implied in specific contexts particularly in relation to contracts for the provision of services, or to give business efficacy to a particular contract. Moreover, in many contexts, terms implied in fact or law or by construction will serve the same functions in particular fact situations as an implied obligation to act in good faith"*[58]

The High Court has not yet addressed the issue of a general overriding duty of good faith.

In *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5, whilst not determining the matter, Kirby J observed that the idea of an implied term of good faith and fair dealing "appears to conflict with fundamental notions of caveat emptor that are inherent (statutes and equitable intervention apart) in common law conceptions of economic freedom". He also stated that such an implied term "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". Callinan J did not go so far, describing the arguments put by the lessee on the basis of the New South Wales Court of Appeal authorities mentioned below as "rather far-reaching".

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[56] *The meaning of contractual 'good faith' by Dr Elisabeth Peden*
[57] *Interpretation, Good Faith and the 'True Meaning' of Contracts: The Royal Botanic Decision by JW Carter and Andrew Stewart.*
[58] *Halsbury's Laws of Australia/Contract/Terms and Parties/Implied Terms/Terms implied in Law*

Further, Gummow J pointed out in 1993, "[t]he implication of a term by operation of law, applicable across the whole spectrum of the law of contract, is a major step" (*Service Station Assn Ltd v Berg Bennett & Associates Pty Ltd* (1993) 45 FC 84 at 97) and held that Australian law had not yet taken this step as regards an implied term of good faith and fair dealing in performance.

The SCCA's legal advisers have reviewed the key authorities on "good faith" and have concluded that 'good faith' takes on different meanings depending on its context[59] In their view this is neither surprising nor unsatisfactory given that it is really a principle or policy deriving from and guiding the implication of terms and/or the construction of existing terms rather than being itself a legal norm.

In the view of our legal advisers the exact content of any implied obligation of good faith depends on the type of contract, the factual matrix and the parties involved etc.[60] An obligation of good faith cannot stand on its own. There must first be an agreement with an objectively ascertainable common purpose(s) with respect to which the parties must be able to be 'faithful'. It makes no sense to simply say that parties must perform in good faith. Rather "[w]e must know what terms they will be performing. If we are then requiring those terms to be performed in good faith, really all we are doing is explaining the standard to which they must perform."[61] In this way the obligations of good faith fills in the gaps.

As is said in Section 205 of the 'Restatement Second of Contracts'[62] the underlying ethic in good faith performance and enforcement of a contract is a "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party"[63].

'Good faith' need not require fairness or regard to the other party's interests, "since the contract allows a self-interested approach, so long as it is loyal and consistent with the contract's objectives and spirit." [64] If, for instance, "a party makes clear that it will be seeking nothing less than the most favourable terms, the other party can only reasonably and legitimately expect that the first party will act in an entirely self-interested fashion and accordingly obligations of good faith will be minimal." [65]

It is for these reasons that 'good faith', as being applied sporadically by the Courts, is not regarded as an affront to the doctrine of sanctity of contract. It is for this reason also that 'good faith' is not suitable as a statutory duty. It describes a principle, not a legal norm, which is used to construe and/or imply contractual terms and would be poorly translated into a statutory provision.

In terms of the key authorities in *Alcatel Australia*, Sheller JA (Powell JA and Beazley JA agreeing) said (at p.368):

"If a contract confers power on a contracting party in terms wider than necessary for the protection of the legitimate interest of that party, the courts may interpret the power as not extending to the action proposed by the party in whom the power is

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[59] See eg Aiton Australia Pty Ltd v Transfield Pty Ltd (2000) 16 BCL 70 at [156] per Einstein J; R Brownsword
[60] The meaning of contractual 'good faith' by Dr Elisabeth Peden
[61] Contracts: Good faith in the performance of contract law by Dr Elisabeth Peden
[62] Restatement of the Law of Contracts (Second reprinting) adopted and promulgated by the American Law Institute at Washington DC, May 17 1979 and published 1981 (hereafter referred to as "Restatement Second of Contracts" or "Restatement Second".
[63] Comment accompanying s.205.
[64] The meaning of contractual 'good faith' by Dr Elisabeth Peden
[65] Too Much Concern Too Soon? Rationalising the Elements of Section 51AC of the Trade Practices Act by Philip Tucker

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] of saying the same thing."

The reference to good faith concepts here is a reference to concepts which guide the construction of contracts and is consistent with the modern approach of giving effect to what the parties are construed to have intended: see *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*. No overriding duty of good faith is imported. Rather the particular wide express clause is read down to give effect to what the parties are construed to have intended.

In *Far Horizons Pty Ltd v McDonalds Australia Ltd* [2000] VSC 310 at [120], Byrne J said:

"I proceed, therefore, on the basis that there is to be implied in a franchise agreement a term of good faith and fair dealing which obliges 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. Such a term is a legal incident of such a contract."

Also in *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703 (43,008), Finkelstein J said:

"There is no reason to think, prima facie at least, that the obligation of good faith and fair dealing would not act as a restriction on a power to terminate a contract, especially if that power is in general terms."

These cases are again illustrations that an obligation of good faith may be implied to fill in the gaps where a discretion/power given to one party on its literal terms is wider than was intended (as objectively ascertained).

In *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, Sheller JA, Beazley JA and Stein JA said:

"For a term to be implied at law, in a new category of case [such as good faith] it must be both reasonable and necessary: see Castlemaine Tooheys and Byrne. In Byrne, McHugh J and Gummow J explained the meaning of necessity in this context. They said (at 450) "Many of the terms now said to be implied by law in various categories of case reflect the concern of the courts that, unless such a term be implied, the enjoyment of the rights conferred by the contract would or could be rendered nugatory, worthless, or, perhaps, be seriously undermined. …Hence, the reference in the decisions to 'necessity'. …"

In that case the Court noted that the franchisor had been given in the agreement a "sole discretion" which, interpreted literally, would have allowed it:

"… to give or to withhold relevant approval 'at its whim' including capriciously, or with the sole intent of engineering a default of the Development Agreement, giving rise to a right to terminate".

The Court then said:

"In our opinion, applying the words used by McHugh J and Gummow J in Byrne (at 450), the 'enjoyment of the rights conferred by the contract would or could be rendered nugatory, worthless or perhaps seriously undermined' if the clause was able to operate in the matter for which Burger King Corporation contended."

The Court found:

"That being so, it reinforces our view that Burger King Corporation's contractual powers under cl4.1 are to be exercised in good faith and reasonably. That does not mean that Burger King Corporation is not entitled to have regard only to its own legitimate interest in exercising its discretion. However, it must not do so for a purpose extraneous to the contract – for example, by withholding financial or operational approval where there is no basis to do so, so as to thwart Hungry Jack's Pty Ltd's rights under the contract."

Properly understood this decision does not represent a major new development in the law, but rather is an application of established principles of interpretation and implication, which results in the particular clause 4.1's wide (literally unfettered discretion) being read down.

That this is the correct interpretation is evident from a recent decision of the NSW Court in *CGU Workers Compensation (NSW) Ltd (ACN 003 181 002) v Garcia* – BC200706429 per Mason P, Hodgson and Santow JJA, in which the Court said that:

- *"The worker points to decisions of this Court recognising that some commercial contracts contain terms implied as a matter of law imposing an obligation of good faith and reasonableness in the performance of contractual obligations (Alcatel Australia Ltd v Scarcella (1998) 44 NSWLR 349 at 369; Burger King Corporation v Hungry Jacks Pty Ltd [2001] NSWCA 187 at [159], [164]; Vodafone Pacific Ltd v Mobile Innovations Ltd [2004] NSWCA 15 at [125]).*

- *These cases do not establish that such an implied term is to be inserted into every contract or even into every aspect of a particular contract."*

- *"In determining whether the implication is to be drawn form a particular class of contract, courts ask range of questions that include whether the contract would be effective without it, and whether the enjoyment of the rights expressly conferred would or could be rendered nugatory, worthless or perhaps be seriously undermined. The central criterion is one of "necessity", a matter to be tested against any applicable statutory policy (see Byrne v Australian Airlines Ltd (1995) 185 CLR 410 at 450; Breen v Williams (1995) 186 CLR 71 at 80 102-3 and 124; Hughes Aircraft Systems International v Airservices Australia (1997) 76 FCR 151 at 193-5)."*

A review of the key authorities therefore reveals that there is no overriding duty of good faith in equity or common law but rather "good faith", "reasonableness" etc are concepts which are as a matter of construction or by construction used to fill in the gaps of contractual provisions but only where it is not inconsistent with the express provision to do so – thus ensuring the sanctity of contract. Where there is a fixed term lease which expires on a certain date there is no gap to fill and therefore no common purpose in respect of which 'good faith' may operate.

Having regard to the above this Committee should appreciate that when Associate Professor Zumbo describes 'good faith' as something different, and suggests that concept "would be one way to make explicit the underlying ethical standards of the industry as a whole", he is really talking about 'fairness' – a principle he has long championed[66], as a legal norm. His attempts to cloak 'fairness' under the guise of 'good faith' - to suggest it is respectable, legitimate and accepted as a judiciable legal norm - should be seen for what they are.

[66] *See submission to Reid Committee in 1997.*