

PART XII – IMPLIED TERMS

I INTRODUCTION

A *The Role of Implied Terms*

Parties cannot possibly contemplate every contingency that may arise and alter the operation of the contract, so that gaps are inevitably left in the express contractual terms of an agreement.

For this reason, the courts are prepared to imply terms into contracts. Several methods and justifications are applied to the implication of terms.

B *Methods of Implication*

There are three classes of implied terms. These terms may be implied by law or by fact:

- 1 Terms implied by law are said to be imposed on the parties regardless of their intention (on the basis of policy); there are two types of terms implied by law:
 - a) *Universal terms* – implied by law into all contracts; and
 - b) *Generic terms* - implied by law into particular classes of contract
 - i The relevant test is 'necessity'
 - ii The exact scope of each class is usually unspecified
- 2 Terms implied in fact are said to be based on the presumed intention of the parties (on the hypothesis that the parties would have included them if they had thought of them); specific terms are generally tailored to the particular contract under consideration
 - a) The relevant test is the *BP Refinery* test

II UNIVERSAL TERMS

A *Duty of Cooperation*

1 *The law in Australia*

In *Butt v McDonald*, it was stated that

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

The duty to cooperate usually arises as a specific obligation that applies to the circumstances. Courts apply the universal duty to the facts of the case, generating a more precise obligation.

Terms will only be implied to the extent of consistency with the express terms of the contract. Express provisions prevail over implied terms, except (arguably) in relation to certain duties, such as the duty to act in good faith under UNIDROIT provisions.

In Australia, a duty to cooperate is implied into every contract (*Secured Income v St Martins*).

Secured Income v St Martins:

Facts

- SI sold a large office block to SM
- \$170,000 remained owing after settlement, which was made on 26 January 1973
- This was payable by 26 May 1973
- The contract provided for the reduction of this sum by a formula if aggregate rents had not reached a specified figure by that time
- It also provided that leases of the premises after execution of the agreement (but before completion) should be approved by SM – approval was not to be capriciously or arbitrarily withheld
- The aggregate rents were far below the specified figure
- As a result, SI offered to lease so much of the vacant premises as would increase the aggregate rent to a level that the \$170,000 would not be reduced
- SM rejected this offer and, as a result of applying the formula to the vacant offices, the amount owing to SI was reduced to zero
- SI sued for damages for breach of an implied term that SM would actively co-operate in efforts to secure tenants, alleging that this term had been breached by SM's rejection of SI as a tenant

Issue

- Was there an implied term in the contract compelling SM to cooperate with SI by taking reasonable measures to carry out the contract?

Reasoning

- There was an express term that SM had to be reasonable in granting or rejecting approval of tenants
- There is also an implied contractual obligation to do only all *reasonable* things to act in cooperation
- However, SM would only be in breach if, without reasonable cause, the SM does not do all reasonable things to act in cooperation
 - Thus, if SM's refusal of SI was based on a characteristic of the tenant that it would be reasonable for a lessor to take into account (eg, insolvency), then they would not be in breach
 - Trial judge: satisfied that SM's motivation for rejecting SI was based on concerns about their ability to pay the rent
- The *Butt v McDonald* formula should be qualified by the word 'reasonable' – the parties need only do all things which are *reasonably* necessary to ensure the other party derives their rights or benefits under the contract
 - The benefit of the contract for SM was purchase of the office complex with guaranteed rental income
 - The benefit of the contract for SI was sale of the office complex
 - Here, the specific obligation placed upon SM is to act reasonably in deciding whether to accept a tenant

Decision

- A duty to cooperate is implicit in the contract, but it has not been breached by SM, who rejected SI as a tenant on reasonable grounds

2 *Theoretical perspectives*

Stoljar (1953) argues that the duty to cooperate may be seen as both a negative duty – to refrain from hindrance of the other party – and a positive one – to ensure the full realisation of the bargain:

Since the fundamental and pervasive theory of the common law of contract is that of a bargain between two parties, the natural – though by no means obvious – corollary is that the parties must mutually co-operate to enable and facilitate the fulfilment of their bargains; the corollary is, in other words, that the law must so control and direct performatory conduct between the parties as to secure the full protection of their respective bargain-interests.

To be more particular and precise this basic requirement of co-operation must be stated in two parts:

- *Reduced to its lowest terms, the general duty to co-operate becomes but a duty not to prevent or hinder*
- *On the other hand, the requirement of co-operation may turn into a distinctly positive duty to take all such necessary steps in the performance of the contract that will either materially assist the other party or will generally contribute to the full realisation of the bargain*

3 *Notes*

It is not inherent in a contractual relationship that the parties must take measures to protect one another beyond performing their obligations under the contract.

Prima facie, there is no reason why parties should not always be free to exclude such an implied term. Contracting parties are, after all, the focus of any contractual agreement, and their intention – which is the very force that brings the powers of the state to bear upon a breaching party – ought to prevail over that of the law, whatever its objective.

However, this may have the effect of allowing stronger parties to exclude the term at the expense of the weaker party, by allowing them to use their greater resources to act to the detriment of (or simply fail to assist) the other party in furtherance of their own interests. Such an outcome would suggest that the term ought always to be implied as a positive duty to do all that is reasonably necessary to assist the other party. However, this is also an unacceptable burden.

The best balance between these two extremes is to imply the a duty to cooperate in its negative form as term into all contracts by default, but to allow its exclusion in contracts of (and only of) a commercial (and not consumer) context. This way, significantly weaker parties could still be protected by the term, without hindering the efficiency of business transactions or the freedom of the rational actors to contract on their terms. Implying only the minimum (negative) duty is to recognise that modern contractual arrangements do not necessarily entail an endeavour to assist the other party; more often, contract is invoked as a mechanism to protect or secure a right or benefit for oneself, at the expense of another. This is not to say that the rights and interests of contracting parties do not overlap – as where, for example, the promisor is performing a service for the promisee in return for payment – just that it is overly interventionist to require that they always do.

B *Duty to Act in Good Faith*

1 *Introduction*

The purpose of implying a duty to act in good faith is to prevent certain types of opportunistic or unreasonable conduct during the course of contract performance. The duty supplements the express terms of a contract to regulate the manner in which parties perform and enforce their contracts.

Traditionally, a general implied duty of good faith has not been recognised in Australian or English contract law. However, there is increasing interest in Australia in the possibility of such a duty.

2 Overseas Approaches

United States:

- The *Uniform Commercial Code (#1-203)*, which has been adopted by legislation in all states, and *Restatement, Second, Contracts #205* (which although it does not have statutory force, has been adopted by the American Law Institute and is generally applied by the courts as an authoritative statement of law) both contain provisions imposing a duty of good faith upon contracting parties
- #205 states that

[e]very contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement.

In common law jurisdictions, Canada and New Zealand are moving towards the recognition of an implied obligation of good faith.

European civil codes:

- All European civil codes recognise an obligation to act in good faith
- UNIDROIT has adopted an implied duty of good faith

3 History in Australia

Traditionally an obligation of good faith is only imposed in two contexts:

- Parties to an insurance contract (statutorily implied); and
- On fiduciaries (a person occupying a position of trust vis-à-vis another person)

However, many doctrines are evolving in a manner that enforces standards of good faith (consider the doctrine of estoppel, the use of restitution in *Trident*, and judicial interpretations of the *Trade Practices Act*).

A duty to act in good faith was first recognised by Priestley JA in *Renard Constructions* (1992, NSWSC CA).

Renard Constructions v Minister for Public Works:

Facts

- RC and the Minister were parties to a building contract
- Clause 44.1 gave the Minister the right to exercise certain powers (including the right to suspend payment and terminate the contract)
- This clause was invoked because of what the Minister considered delay and poor

workmanship of the contractor. However, the delay was due, in large part, to the failure of the Minister to supply the requisite materials on time

- In response, RC delivered a letter saying it was willing and able to complete the contract and had employed additional staff and a more experienced foreman
- The officer who ultimately made the decision to terminate the contract was not aware of the Minister's failure to supply the materials or of the improvements the contractor had implemented (including those outlined in the letter)
- RC treated the officer's action as a wrongful repudiation of the contract which it accepted and on this basis RC rescinded the contract
- Arbitration proceedings were commenced and the arbitrator found that Minister (through his officer) had breached the contract by acting unreasonably in exercising the power in clause 44.1
- The Minister successfully appealed to the Supreme Court on the basis that the arbitrator proceeded on the incorrect presumption that the contract contained an implied requirement of reasonableness
- RC then appealed to the Appeal Division of the Supreme Court, claiming that the agreement did in fact contain such an implied term

Issue

- Did the contract of construction contain an implied duty to act reasonably such as to require the Minister to terminate on reasonable grounds?

Reasoning

- If the term is to be implied in fact (as a specific term), then without the implied term the contract would need to be quite unworkable (making it necessary to imply the term to give the contract business efficacy)
 - Here, that requirement is met, because if M was able to terminate at any time without having to show cause, the rights conferred under the contract would be essentially worthless; this would be unfair and not efficacious
 - However, just because the contract is effective without the term does not indicate conclusively that it is not needed
 - Look at the business efficacy of the contract without the term: the contract needs to be unworkable in order to imply a term in fact
- If the term is to be implied in law (as a generic term), then, for similar reasons, the relevant test of 'necessity' was met
 - The test for implying a general term in law is very similar to that for the implication of a specific term in fact, though the test is not dealt with specifically
 - At a minimum, the Court has implied a duty to act reasonably into all building contracts
- A duty to act in good faith was not implied into all contracts
 - Priestly JA: limits the duty to building contracts
 - It is both a generic term (law) *and* a specific term implied in fact – it can be both
- The duty to act in good faith/reasonably was breached by M:
 - M terminated a *major* contract without even asking for an explanation of the delay
 - This termination was unreasonable, because the delay was caused by M and was not the fault of Renard Constructions
 - Good faith is equated with reasonableness

Decision

- The contract contains an implied duty of good faith which limits the way in which the

- rights in clause 44.1 could be exercised by the Minister
- Because the Minister had not exercised the power conferred by cl 44.1 in good faith (reasonably), they are in breach of the contract and RC can renege on their obligations

However, the duty to act in good faith was not well received by Gummow J in *Service Station v Berg* (1993, Federal Court).

Service Station v Berg Bennett:

Reasoning

- Gummow J is opposed to the invocation of community standards in the application of the good faith doctrine:
 - Courts should not imply a term of reasonableness because this leads to judicial misunderstanding/misconstruction of terms
 - The phrase ‘the minister must terminate reasonably’ would need to be inserted as an express term in the contract to import a duty to be reasonable in that regard – there should not be a universal standard of good faith
 - This is a very narrow approach – the implication of good faith is openly resisted
- Gummow J rejects a universal obligation of good faith:
 - Having available a duty to act in faith is a license for the exercise of judicial intuition that would contradict the intention of the parties
 - Though a duty may have been implied universally in other jurisdictions, the exact *meaning* of the duty is uncertain
 - If the parties wanted terms that imported a requirement of reasonableness, the parties would have done so expressly – it should not be up to the judiciary to put words in the parties’ mouths
 - But: if there is not a requirement of good faith, policy may just be masked under the guise of construing the terms, so as to achieve the same outcome

Since *Berg*, there has been positive treatment of the duty to act in good faith by Finn J in *Hughes Aircraft v Airservices Australia* (1997, Federal Court) and Sheller JA in *Alcatel v Scarella* (1998, NSWSC CA).

Note Finn J’s comments to the contrary in *Hughes v Airservices Australia*, who in *obiter* noted the following:

- The policy factors raised in *Renard* mitigate towards an implication of a duty to act in good faith
- There should be an awareness of fairness and reasonableness

In *Alcatel Australia v Scarella*, Sheller JA also indicated that there should be an implied duty to act in good faith, and rejected the notion that a consideration of fairness would be problematic:

If a contract confers power on a contracting party 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 of saying the same thing.

Sheller JA also noted in that case that:

- Other doctrines (estoppel, etc) have openly considered fairness
- Fairness should not be an issue in implied terms; the courts should set a minimum standard of conduct

Since the *Hughes Aircraft* decision, an increasing number of cases have sanctioned the implication of a duty to act in good faith. In that case, not conducting a tender fairly was in acting in faith. Dictum in *Hughes Aircraft* called for the universal implication of a duty of good faith.

Note, however, the High Court's comments in *Royal Botanic Gardens*, where Kirby J noted that an overly expansive approach may soon be curtailed (*Berg* approach).

4 Current Content

Australian courts have not gone very far in explaining the general method by which compliance with an implied duty of good faith should be assessed.

The current content of the duty to act in good faith, where it arises, appears to be as follows:

- The duty prevents parties from exercising contractual powers 'capriciously' or for an 'extraneous purpose' (*Burger King*)
- The duty does not prevent parties from pursuing their legitimate interests (*Garry Rogers v Subaru*)
- A duty to co-operate is most likely to be included as one of the obligations imposed by a larger duty of good faith (*Secured Income v St Martins*)
- It is often suggested that the duty of good faith requires parties to act reasonably in performing their contractual obligations (*Renard Constructions*)

Burger King v Hungry Jack's:

Facts

- Burger King ('BK') conducted a worldwide franchised fast food system
- In 1990 BK and Hungry Jacks ('HJ') entered into a 'Development Agreement', which:
 - Gave HJ an unrestricted, non-exclusive right to develop restaurants in Australia
 - Required HJ to develop a total of at least four restaurants per year
 - Required HJ to obtain approval for each new restaurant from BK
- Clause 4 of the Agreement provided that approvals were at the 'sole discretion' of BK. It also specified a number of matters relevant to the approvals
- From 1993, BK decided it wanted to take a more active role in the Australian market.
- In 1995, BK imposed a freeze on HJ recruiting third party franchisees. It also withdrew financial and operational support from HJ. This had the effect of impeding HJ's development of new outlets
- BK also refused to give the approval needed for the franchisee to comply with the requirement to develop four restaurants per year
- In 1996, BK terminated the Development Agreement because HJ had not developed the required number of stores
- HJ sued BK alleging that BK had breached implied terms, including the implied duty of good faith

Issue

- Was BK in breach of an implied obligation to take all reasonable measures to allow HJ to enjoy its rights under the contract by acting unreasonably when exercising its powers of approval?

Reasoning

- HJ argued that a duty to act in good faith was implied in the Development Agreement:
 - The promise made by BK would have been illusory without it since they had the ability to thwart any rights conferred upon HJ to develop restaurants
 - The test of necessity indicates it should be implied – unless the term is implied, the enjoyment of rights conferred by the contract would or could be rendered worthless or nugatory
- BK argued that if the parties had wanted to force BK to act reasonably, it would have been put in the contract, and that, since such a term is absent:
 - Any implication subverts or distorts the interests and intentions of the parties
 - The parties have agreed that BK has sole discretion
 - The obligation requiring them to act reasonably would be inconsistent with the express term granting 'sole discretion'
- The Court rejected BK's arguments, siding with HJ and implying a term requiring BK to act in good faith by law
 - *Burger King* limits the implication by law to development agreements (generic term)
- In Australia, there is no distinction of substance between the duty to act reasonably and the duty to act in good faith (if one is implied, the other will be too)

Decision

- BK had breached the obligation to act in good faith by exercising their rights capriciously (without regard to HJ's enjoyment of rights) or for an extraneous purpose (generating a cause to terminate the agreement and expand into the Australian market)

Note also *Far Horizons v McDonald's Australia* (Victorian SC), where a duty to act in good faith was recognised as a generic term in commercial contracts. There, allowing a second restaurant to open very close to the plaintiff's store was *not* in breach of the universal duty because McDonald's was not acting maliciously in doing so (no specific intention to deny plaintiff opportunity). Thus, the duty was characterised as merely negative in obligations (Stoljar).

Other pronouncements of the duty's content:

- Motive to harm the other party is in breach
 - Purpose 'extraneous to the contract' or acting 'capriciously' (*Burger King*)
- Pursuit of legitimate commercial interest is not in breach
 - *Far Horizons*
 - *Gary Rogers* (see below s 6)
- Bad faith is in breach (excluder thesis)
 - Construe the duty negatively – a duty to do anything that isn't in bad faith
 - Summers
 - Priestly JA in *Renard*
- Pursuit of self-interest cannot be unconscionable (core meaning thesis)
 - *Aiton Australia* (per Einstein J)
 - *New Ltd* (per Finn CJ) – 'core meaning' of the duty is a 'loyalty to the contract'
- Obligation to cooperate; honesty; reasonableness
 - Sir Anthony Mason (see below s 5)

5 Theoretical analysis

Sir Anthony Mason has commented that good faith embraces no less than three related notions:

- An obligation on parties to co-operate in achieving contractual objects (loyalty to the promise);
- Compliance with honest standards of conduct; and
- Compliance with standards of contract which are reasonable having regard to the interests of the parties.

The duties to cooperate and act reasonably seem to be incorporated within this conception of good faith.

The duty to cooperate is universal; however, the duty to act in good faith is not always implied. Thus, there can be a duty to cooperate in the absence of a duty to act in good faith. To the extent that these duties overlap, this is inconsistent.

6 Legitimate interests

The standard of conduct required by a duty of good faith has sometimes been described by reference to a party's legitimate interests.

In respect of a party's legitimate (reasonable) interests, good faith will not operate so as to restrict decisions and actions – reasonably taken – which are designed to promote them, provided the conduct is not in breach of an express contractual term (*Garry Rogers v Subaru*).

Garry Rogers v Subaru:

Facts

- GR was appointed by S as an authorized dealer
- Under the dealership agreement, either party could terminate the agreement *without* cause by giving written notice 60 days prior
- S implemented a new marketing program aimed at improving the image of its dealers in the marketplace
- GR indicated that it was not willing to comply with the program
- As a result, S exercised its right to terminate the dealership agreement
- In response, GR indicated that it would implement the program
 - This was not done to capriciously punish GR, but to act in its own interests
- Despite this, S refused to withdraw its notice of termination

Issue

- Was S's refusal to change their mind a breach of an implied duty to act in good faith?

Reasoning

- Finkelstein J:
 - The existence of an implied term of good faith and fair dealing was not in issue between the parties
 - Obiter dicta: such a term will *ordinarily* be implied into all commercial contracts
 - A narrow interpretation of this duty is adopted:

The duty of good faith will not operate so as to restrict action designed to

protect the legitimate interests of Subaru.

- The party attempting to show it hasn't breached the duty must demonstrate its (legitimate) interests, show that they are reasonable, and show that their conduct fell within the protection of those interests
- Subaru did not breach the implied duty of good faith because it was reasonable for S to have legitimate concerns about allowing GR to remain in its dealership program
 - GR was quite critical of S; S doesn't think they're committed to the programme
 - It is in S's interests to dismiss GR from the dealership
 - [Perhaps if S dismissed GR capriciously, as punishment, it would be in breach]

Decision

- Though a duty of good faith is implied into the contract, Subaru did not breach it by terminating the dealership agreement with GR because it was acting in its own legitimate (reasonable) interests when it did so

Aiton Australia v Transfield:

Facts

- Clause 28 of the contract between the parties (a construction contract) set out a dispute resolution procedure, which included obligations to negotiate and mediate in good faith
- The dispute related to whether a promise to negotiate and mediate in good faith when resolving disputes arising under the agreement was sufficiently certain to be enforceable

Issue

- What is the content of an obligation to negotiate in good faith?

Reasoning

- Does the core content of the obligation to act in good faith differ from the core contents of the obligation to co-operate and to act reasonably?
- Einstein J:
 - A promise to negotiate in good faith does not require anything other than self-interest – it just needs to be reasonable
 - Like *Subaru*, the obliged party does not have to adopt a weak negotiating position to satisfy the duty
- Mediating in good faith requires the obliged party to:
 - Subject themselves to the process of negotiation
 - Keep an open mind in respect of any solutions offered
 - Put forward and consider proposals
- Arguably, this is not that different from what would be required by the implied duty to co-operate

Decision

- By subjecting themselves to the negotiating procedure and acting reasonably in that regard, the duty to act in good faith was satisfied

Ultimate question:

- Should contracting parties be subject to a general duty to negotiate in good faith?

- Can such a duty be derived from the duty of good faith implied generally in contracts?
- Can it be excluded by an express term?
 - But: if parties were allowed to terminate a contract without cause, it would be like not having a contract at all

7 *Exercise 5, Seminar 20*

i Legal position

- Reasonable and not capricious
- Negotiation in good faith (*Aiton* – but: express agreement there)

ii Normative position

- Economic school:
 - Megaholdings' legitimate interests in filling places and ensuring their shops open in their centre
 - Contract should not prevent business efficacy, or hinder commercial practices conducive to efficiency
 - One ramification of this is that parties shouldn't have to waste their time negotiating contingencies – implied duties (such as good faith) lessen the requirements for formulating a contract
 - If the parties wanted to, they could have added a term to the effect of: 'if profits are below X, we reserve the right to close'
- Critical legal studies:
 - Reasonableness and legitimacy are vacuous concepts
 - Judicial treatments of fairness are largely incoherent
 - There is a great deal of variation in judicial views on fairness/reasonableness
 - There is no real test of reasonableness and insufficient case law to state a meaning of the duty with any certainty
- To date, the implication of implied duties, and where implied, the meaning ascribed to them, has been largely inconsistent – this can produce greater unfairness than a universal rejection of their implication (possibly followed by a legislative response?)
- For contract to be a standard of conduct in and of itself is to go beyond its role as a mechanism of state enforcement invoked at the request of an individual party
 - At the very least, such a duty should be able to be excluded in a commercial setting

iii Shifting fault

- Assigning fault between the parties; M's conduct would be less unreasonable if M&C was to blame
- 1) Should they have put in an additional term?
- 2) Not their fault for requesting a rent decrease
- 3) Outside both parties' control
- 4) Outside all control

- These situations reflect varying degrees of reasonableness on the part of M
- It is not as simple as saying 'that looks unreasonable'
 - One needs to look at:
 - The legitimate interests of the parties
 - Capricious or extraneous interests

C *The Role of Universal Terms*

Implied terms are only implied to the extent that they are consistent with the express terms of the contract. Thus, in principle, it seems that parties may expressly preclude the implication of a particular term or a particular construction of the express terms.

However, it remains unclear whether such an express term will override an importation of a duty to act reasonably or in good faith (cf *Central Exchange Ltd* – no universal duty of good faith; WASC, 2001).

III GENERIC TERMS

A *The 'Necessity' Test*

Generic terms are implied by law into particular classes of contracts. Generic terms can be implied by one of two bases:

- Trade custom; or
- Inherency in a particular class of contract, such as an implied condition:
 - To observe lawful and reasonable instructions in a contract of employment;
 - Of reasonable fitness and merchantability in contracts for the sale of goods; and
 - In letting a house that it will be reasonably fit for habitation.

The classes of contract in which the law will imply terms are not closed (*Castlemaine Tooheys v CUB*). Courts are thus willing to hear arguments for the implication of new generic terms into novel classes of contract.

Examples of classes of contract:

- Sale of land (*Whitlock v Brew*)
- Professional services (*Marx v CCH*)
- Parts and labour supply (*L'Estrange*)
- Carriage of goods by sea (*Port Jackson*)
- Leases (*Musumeci v Winadell*)
- Construction (*Renard Constructions*)
- Employment (*Byrne v Australian Airlines*)
- Carriage of passengers (*Oceanic Sun Line v Fay*)
- Bailment
- Banking (*Banque Brussels v ANI*)
- Conferment of rights (*ABC v APRA*)
- Franchising (*Burger King v Hungry Jack's*)
- Tender (*Hughes Aircraft*)

- Exclusive distributorship (*Hospital Products*)

Treatment of these classes has been increasingly broad, allowing terms to be implied across a wider range of contracts:

- Commercial contracts (*Burger King v Hungry Jack's*)
- Standard form contracts (*Renard Constructions*)

A term will only be implied into a class of contract if the Court deems it necessary to prevent its efficacy from being 'seriously undermined' (*Byrne v Australian Airlines*).

Byrne v Australian Airlines:

Facts

- B was employed by AA as a baggage handler; B was dismissed for pilfering
- B sought relief, claiming that his dismissal was in breach of the *Transit Workers (Airlines) Award 1998*, which provided that termination of employment by an employer should not be harsh, unjust or unreasonable
- B sought damages for breach of contract, arguing argued that the award term was also an implied term of his employment contract

Issue

- Was AA in breach of an implied term requiring termination not be 'harsh, unjust, or unreasonable'?

Reasoning

- In order to be implied as a generic term into a particular class of contract, a term must satisfy the necessity test:
 - A term will not be implied by law into a particular class of contract unless the enjoyment of rights conferred by the contract would or could be rendered nugatory, worthless, or perhaps, seriously undermined unless the term is implied
 - Essentially, the basis of the contract must be seriously undermined
- Such a term should not be implied in a contract of employment:
 - Benefits are still conferred upon an employee by the contract, which is thus not worthless
 - (Cf *Renard*: the right to terminate has to be exercised fairly)
 - Is it undermined? *Renard* would seem to indicate that this is possible
 - But note the difference in the class of contract: construction as opposed to employment
 - The class of contract is an *important* factor in whether a term is implied
- The difference between implying a term because it is inherent in a class of contract and implying a term because it is necessary for the effective operation of the contract is that an inherent term is universal (ie, generic) to that class, whereas a term specific to a particular contract's effective operation is factual (ie, specific)

Decision

- It is not necessary to imply the award term into the class of employment contracts, so AA cannot have been in breach

Exam note: note similarities between the facts of the hypothetical scenario and those of any relevant cases. Be aware of the factual features and policy arguments that distinguish different classes of contract.

The apparent discrepancy between *Byrne* and *Renard Constructions* may be explained by reference to the class of contract of which the agreement in dispute partook.

In *Renard Constructions*:

- A duty to act reasonably was implied into all contracts of construction (the class to which the contract in question belonged)
- Priestly JA:
 - The only reason for implying terms is if the parties generally would have wanted them
 - Applied the *BP Refinery* test to the facts; implication in fact is successful
 - Recognises the nature of standard form contracts; term implied into all standard form contracts, though the ‘necessity’ test was sidestepped in order to do this

Similarly, *Burger King* recognised a generic term particular to a single class of contract:

- Here, the duty to act in good faith was implied into all contracts of development (the class to which the contract in question belonged)
- The question for consideration as, ‘should a general duty of good faith be implied into the class of development agreements?’
- Prior to *Burger King*, this was not a recognised class; this demonstrates that it is always open for parties to show that it is *necessary* to recognise a new term in a novel class (the Court also endorsed the necessity test)
 - But: the Court uses the operation of the particular contract to justify implication of the duty generically
 - Arguably, this blurs the line between fact (specific) and law (generic)

Thus, while a term may be necessary for the effective operation of a contract of development or construction, the same term is *not necessarily necessary* for the effective operation of contracts of another class (eg, a contract of employment). This seems to be what the decision in *Byrne v Australian Airlines* is indicating by finding that it is not necessary to imply a term requiring reasonable termination into contracts of employment, despite that necessity being recognised by *Renard Constructions* in the context of contracts of construction.

B *Implication by Trade Custom*

Generic terms may also be implied into contracts on the basis of custom (that is, a well-established usage of the term in a particular trade, profession, or industry).

The basis for implication is that if a custom is ‘well known and acquiesced in’, then ‘everyone making a contract in that situation can reasonably be presumed to have imported that term into the contract’ (*Con-Stan Industries*).

The requirements for a term to be implied by custom are that the term be:

- Notorious
- Uniform
- Reasonable; and
- Certain

These requirements are strict and consequently there are few examples of terms implied by custom (*Con-Stan Industries v Norwich*).

Con-Stan Industries v Norwich:

Facts

- C paid an insurance premium to a broker who arranged its insurance with N
- The broker went into liquidation before passing the payment on to N
- N, the insurers brought, an action seeking to recover the payment from C
- C sought to establish that contracts of insurance contained a term implied by custom, to the effect that where a contract of insurance was arranged by a broker, the broker, not the insured party, was liable to pay the premium to the insurer.

Issue

- Was there was an implied term in the contract of insurance to the effect that the broker was liable to pay, and not C?

Reasoning

- The circumstances in which trade, custom or usage may form the basis for the implication of terms into a contract are restricted by several principles
- Key principles:
 - Notoriety
 - Whether the existence of a custom or usage will justify the implication of a term into a contract is a question of fact;
 - There must be evidence that the custom relied on is so well known and acquiesced in that everyone making a contract in that situation can reasonably be presumed to have imported that term into the contract (although it is not necessary that the custom be universally accepted);
 - This prevents one party from denying that they personally accepted the term alleged to be implied by custom
 - A person may be bound by a custom notwithstanding the fact that he had no knowledge of it – the degree of notoriety of the custom is the focus;
 - This is still a high standard; the custom needs to be very well established before it will be implied as a contractual requirement
 - Uniformity
 - A term will not be implied into a contract on the basis of custom where it is contrary to the express terms of the agreement;
- The term was not implied on the basis of custom:
 - There is insufficient evidence of its notoriety – it is not, in fact, generally accepted that once a broker is paid by the client, the client's liability is extinguished to the insurer
 - The test is *not* satisfied by evidence supporting what 'ordinarily' goes on
 - General acceptance needs to be shown
 - Here, the fact that the broker 'normally' pays the insurer on the client's behalf is insufficient
 - C would have needed to have shown that insurers never claim from the insured – which is not the case, since brokers are often not used
 - Insurers are thus entitled to look beyond the broker – *this* is accepted
- A term implied on the basis of custom is said to be implied on the basis of law (as a

generic term implied into contracts of that class)

Decision

- Because it could not be established that it is a generally accepted trade custom that insurer only collects payment from the broker, a term to that effect could not be implied by custom and C is liable to pay N directly

Recall: *Byrne v Australian Airlines*

- A term prohibiting unfair dismissal was not implied on the basis of custom:
 - There was a lack of evidence as to what was the custom, if any
 - At any rate, the Court was not satisfied that a custom of reasonable dismissal – even if established – could be sufficient to import a term that dismissal *must* be reasonable
- The difference between implying a term because it is inherent in a class of contract and implying a term prescribed by custom is that a custom doesn't have to be 'necessary' to give effect to the contract – it just might be the most efficient/accepted way of conducting the transaction – whereas a generic term is a necessity if the contract is to be effective

IV SPECIFIC TERMS

A *Implication by Fact*

Terms implied in fact (specific terms) are tailored to, and therefore unique to, the particular contract in question. Such terms are traditionally said to be based on the presumed intention of the contracting parties (*BP Refinery, Codelfa Constructions*).

B *Written Contracts*

In order to be implied, the *BP Refinery* test must be satisfied. The implied term must be:

- Capable of clear expression;
 - The initial consideration: look at the facts, look at the nature of the term, and establish that it can be clearly expressed with adequate precision
 - Expressly having to use terms such as 'fair', 'reasonable' mitigates against being capable of clear expression (though not conclusive)
- Reasonable and equitable;
 - If the implied term would impose an arduous burden on one party, it is unlikely to be inferred
- Necessary to give *business efficacy* to the contract (so that no term will be implied if the contract is effective without it);
 - Whether or not a reasonable business person would consider that the proposed term was necessary to enable the contract to operate in a business-like manner

- So obvious that it goes without saying; and
 - Mason J warns against hastily concluding that a term is obvious
- Not contradict any express terms of the contract.
 - The express terms always take precedence
 - Look at express words which might be *construed* to be inconsistent

This test was devised in *BP Refinery* and endorsed in *Codelfa Constructions*. In the presence of a merger clause, this would be the approach that is adopted.

C Party Written, Party Oral Contracts

Where the written document is not complete, the requirements for implying a term in fact are not so strict. The courts have suggested a flexible approach is required, owing to the incomplete nature of the agreement, which suggests that the parties may not have turned their minds to the term sought to be implied (*Bryne v Australian Airlines*).

In these circumstances, implication may only involve satisfying two requirements:

- Necessity; and
- Obviousness.

(However, the extent of requirements is unclear.)

The *BP Refinery* test was first developed in *BP Refinery v Shire of Hastings*, which involved a dispute over the relevant rate of taxation to be applied to the refinery.

BP Refinery v Shire of Hastings:

Facts

- BP entered into an agreement with the state government to establish an oil facility
- Clause 6 stated that BP can assign rights in the facility to an external company to the extent of a 30% stake
- The Shire of Hastings also assessed BP at a lower rate of taxation according to a preferential agreement
- Six years later, BP was taken over by BP Australia (its local subsidiary); the Shire now sought to tax BP at the normal rate

Issues

- Can the Shire imply a term that the preferential agreement would end if BP no longer owned the refinery?
- Can BP imply a term that the preferential agreement would continue if BP assigned ownership to a company in which it had a 30% share?

Reasoning

- The Shire's alleged term cannot be implied because it
 - Would be inequitable
 - Is not necessary for the contract to fulfil the business efficacy requirement
 - Is far from obvious
- BP's alleged term can be implied, because
 - It is capable of clear expression

- It is necessary, obvious, and reasonable
- It does not contradict the express terms of the contract

Decision

- BP's term is implied, and BP Australia is still entitled to the preferential taxation rating

The *BP Refinery* test has subsequently been approved by *Codelfa Constructions v SRA* (1982, High Court of Australia).

Codelfa Constructions v SRA:

Facts

- CC and SRA entered into a construction contract whereby SRA agreed to complete certain parts of a railway
- The parties contracted on the assumption that construction work could proceed on the basis of three shifts per day. This assumption seemed reasonable as this appeared to be authorized by legislation
- The contract between the parties contained the following provisions:
 - The contract price was payable for all work regardless of difficulty;
 - The contractor was to provide, at its own expense, everything necessary for the completion of the project;
 - The contractor was deemed to have informed itself of everything affecting the carrying out of the work; and
 - All work was to be completed within *130 weeks* of the notice to proceed
- Codelfa commenced operating three shifts a day
- However, because of the noise, dirt, and disruption caused by the construction, local residents obtained an injunction preventing work from being carried out on Sundays and between the hours of 10.00pm and 6.00am
- This increased Codelfa's costs and it made a claim to the SRA for increased payment
- The SRA refused to pay these costs on the ground that they were not provided for in the contract

Issues

- Can Codelfa imply a term that allows reasonable deviation from the stated price due to unforeseen circumstances?
- Can Codelfa imply a term that states that the specification of a completion date is made on the basis of 3 shifts being allowed to operate on every day

Reasoning

- A term allowing 'reasonable deviation' from the stated price would be too uncertain
- However, a term stating the assumption is a possibility; if circumstances change, then, 'upon issue of a restraining order, SRA would issue additional time and pay costs'
- The Court declines to imply a term obliging the SRA to pay extra because the *BP Refinery* test is not satisfied:
 - Reasonable and equitable
 - Mason J: yes
 - Necessary to give business efficacy to the contract
 - No, the contract technically could function without it; it just means that the risk of the assumption changing is borne by the contractor (Codelfa)

- Codelfa were actually granted a time extension under the contract; the issue is just one of payment
 - However, the contract is workable despite reduced profit
 - So obvious that it goes without saying
 - No, this risk is not inherently borne by the SRA, even if a representation had been made by the government that if the assumption on which work proceeded turned out to be incorrect, of course Codelfa should not suffer
 - Mason J: 'SRA looked to Codelfa to shoulder all risks not provided for in the contract'
 - Cf joint ventures or partnerships, where there is a more even sharing of risk
 - At any rate, SRA would not necessarily agree with a risk allocation made against them
 - Mason J: warns against assuming that merely because the parties both contemplated a certain assumed fact situation (operating for 24 hours each day) was in existence, this would be sufficient to imply a term; no, it needs to be *necessary* and *obvious*
 - Capable of clear expression
 - Not necessary to be considered
 - An example of unclear expression would be in the following clause: 'if unforeseen circumstances arise, the parties will act reasonably'
 - Does not contradict any express terms of the contract
 - No, a time limit is specified expressly in the contract
 - The same price is specified regardless of additional costs to Codelfa
- Other notes:
 - To some extent these misgivings are indicative of an underlying judicial uneasiness in implying terms in fact in the face of a contract of apparent finality
 - The parole evidence rule has a role to play in determine what evidence the Court will consider:
 - Mason J: only evidence of the surrounding evidence will be considered
 - Thus, an excerpt from negotiations is unlikely to be admissible
 - The Court cannot look at the negotiation process leading to the formation of the contract
 - The elements of the *BP Refinery* test are to be answered objectively, by reference to the perspective of a reasonable person
 - SRA having to bear the risk of an injunction is not obvious
 - Risk-allocation is an importance part of contract drafting; parties may have considered their potential losses but not referred to them in the contract; the absence of a term could thus indicate that SRA has elected not to bear the risk of injunction and that Codelfa has agreed to this risk-allocation
 - Thus, it is not at all obvious that SRA has assumed the risk of having to pay Codelfa additional money in the event of a contingency; in fact, the opposite has arguably occurred
 - Generally, the more detailed and comprehensive a contract is, the less grounds there are for considering additional terms that have been omitted
 - A court's application of the *BP Refinery* test will generally be stricter in the face of a greater level of detail
- There is a difference between rectification and implying a term in fact; per Mason J:
 - Where a term is to be rectified, there must have been an error in recording the parties' actual intention
 - That is, the parties must have turned their mind to it but made a mistake in expressing the result of that enquiry

- When implying a term, however, the parties are assumed to have never turned their mind to it, and thus to not have had an intention in respect of the issue

Decision

- Due to the otherwise successful operation of the contract, it is still commercially efficacious without the implied term
- Additionally, the particular risk allocation embodied in the contract means that it is not sufficiently obvious that SRA would have agreed to pay Codelfa any additional fee
- Because the *BP Refinery* test is not satisfied, the term will not be implied in fact
- SRA is not liable to Codelfa for any payment additional to that which was already agreed

Some additional examples of terms implied by fact are given below (in the context of cases where generic or universal terms were also sought to be implied).

Recall: *Secured Income v St Martins*:

- 'Leases' did not mean 'commercial leases':
 - SM argued that the leases had to be genuine, commercial leases
 - The Court rejected this approach and instead looked at the words of the provision
 - There was nothing to suggest a constraint upon the meaning of 'leases'
 - The 'words themselves don't preclude SI from taking out a lease; the construction is unsupportable'
- This was actually considered in the context of implying a term, rather than interpreting the language of the provision:
 - A term that 'leases could only be genuine and commercial' was not implied because it was not obvious, nor was it necessary to confer upon SM the commercial benefit of having a tenant (so not necessary for business efficacy)

Recall: *Renard Constructions*:

- Here, the NSWSC CA implied a term to act reasonably in exercising a right to terminate:
 - Priestley JA: business efficacy poses some problems for an attempt to apply a duty of good faith via a specific term
 - Business efficacy is seen as: working in a way ordinarily expected in business
- An implied duty of good faith is implied by law into development contracts:
 - Policy reasons support implication in contracts of this kind
 - Obiter: consideration of whether it would also be implied on the basis of business efficacy (in fact):
 - For the government to be able to dismiss Renard so easily, business efficacy is not present
 - This argument is entwined with a consideration of the fair operation of the contract, resulting in a more lenient application of the *BP Refinery* test

Recall: *Byrne v Australian Airlines*:

- A duty not to dismiss unfairly was not implied in the contract of employment as a specific term because the business efficacy test could not be satisfied:
 - Mason J: the contract can still work; the employee goes on working, regardless of whether their employer can potentially dismiss them unreasonably
 - (Cf Priestley JA: the contract cannot operate fairly without an implied term)

- Partly written, partly oral contracts have a more lenient set of *BP Refinery* criteria applied to them in order to determine whether a term may be implied:
 - All 5 don't need to be satisfied – the test is less stringent
 - The question is whether to imply focuses on what is necessary for:
 - 1) Reasonable operation of the contract
 - 2) Effective operation of the contract
 - *McHugh and Gummow JJ*: obviousness is also important (courts are reluctant to impose abstruse terms onto parties, who may not have agreed to them had they been expressly proposed during negotiations)
 - The term sought to be implied has to be necessary for reasonable and effective operation in order to be applied
 - This is a similar approach to that adopted in *Renard Constructions* by *Priestly JA*
- On the facts, there was no suggestion that the employer was prepared to be bound by all award terms (so the requirement of obviousness was not satisfied)

Recall: *Con-Stan Industries*:

- The Court refused to imply the term, relied on by C, as a specific term
 - A reasonable insurance company would never agree to the inclusion of a term limiting its recovery of premium payment to brokers
 - There is nothing to suggest that the fact of payments being made to a broker should obviously satisfy the requirements of implication
- Business efficacy was not established:
 - N could supply insurance to C without the implied term perfectly well; the contract could function effectively, so the test is not satisfied

V UNIDRIOT PRINCIPLES

A Introduction

UNIDRIOT is an international body that drafts a model contract law. Their principles are a source of comparative study for the judiciary and academics.

B Implied Terms

UNIDROIT Article	UNIDROIT Principle	Differences to Australia	Evaluation
4.8	Where there is no agreement on a term important for determining rights and duties, a term which is appropriate in the circumstances shall be supplied	Will also imply terms, but needs to be based on achieving business efficacy	'appropriate in the circumstances' grants a court too much discretion in the test to be applied; business efficacy – for all its uncertainty – still affords a conceptual framework for implication
5.2	Implied obligations stem from: <ul style="list-style-type: none"> • the nature and purpose of the contract • established practices 	Similar sources to Australia: fact, custom, good faith, cooperation	Classes of implied obligations should not remain closed; additional sources may arise as the nature of consumer and

	<ul style="list-style-type: none"> • and usages • good faith and fair dealing • reasonableness 		business transactions change
1.7	Each party must act in accordance with good faith and fair dealing in international trade - this duty is not excludable	Not as widely accepted; decided on a case-by-case or according to specific classes of contracts	This effectively imposes obligations on a party not under the jurisdiction of the Court; attempts to make good faith an international norm, which may not always be appropriate; eg, different commercial practices/standards in different cultures
5.3	Each party shall co-operate reasonably with the other party	Duty to cooperate the same in Australia; universal	It would be somewhat inconsistent with the nature of a bargain if this term were excludable or absent
5.6	Unless otherwise agreed a party is bound to render a performance of a quality that is reasonable and not less than average	Equivalent provisions in the <i>Fair Trading Act</i> (Vic); <i>TPA</i> (Cth)	Protects the consumer/promisee from being obliged to complete their side of the bargain in the absence of genuine performance by the promisor
1.8	The parties are bound by trade usage except where unreasonable	<i>Con-Stan</i> would suggest a high threshold in Australia; the usage needs to be very well known	Arbitrarily limits the ability of parties to adopt unique or unconventional practices, which may be more efficient than the market norm, since we have an imperfect market
6.1.1, 5.7	Where price or time of performance have been omitted, the price generally charged (or if not available a reasonable price), and performance within a reasonable time, are implied	Failure to specify key details may void the contract; some judges have indicated a willingness to resolve absence of key terms by reference to reasonableness, though some remain unwilling	Technically, the promise is illusory; implying terms may save having to renegotiate, but generally where something as fundamental as price/time has been left out, the bargain is genuinely incomplete and warrants renegotiation; price may be inappropriate in the circumstances; 'reasonable' time arguably void for uncertainty