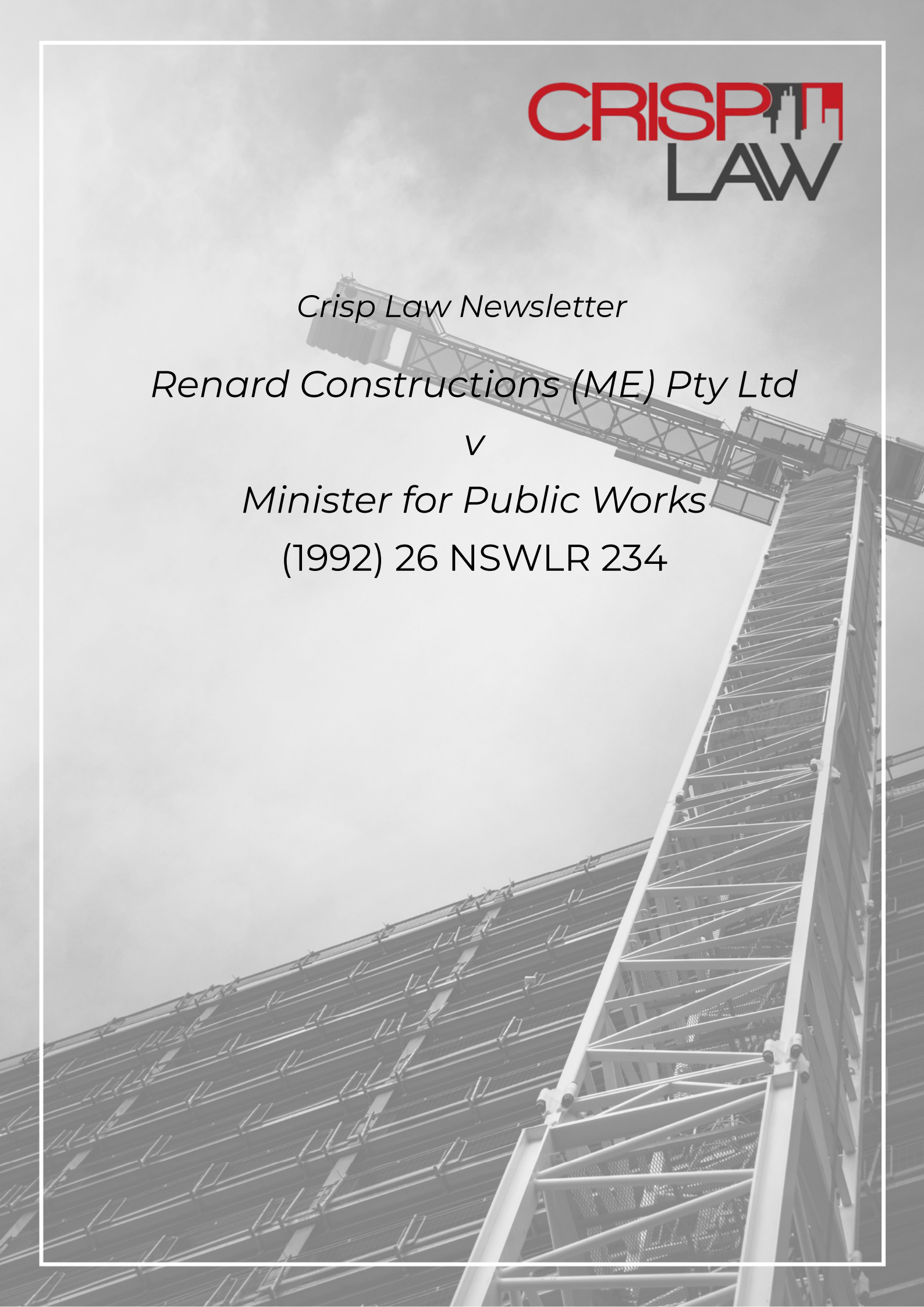

*Crisp Law Newsletter*

# *Renard Constructions (ME) Pty Ltd*

*v*

# *Minister for Public Works*

(1992) 26 NSWLR 234

***In this Newsletter, we discuss the case of Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234. We will discuss the case's significance in understanding the notion of 'good faith' in contractual relationships, and in situations involving show cause notices.**

# Introduction

The notion of good faith has been subject to many judicial discussions, especially within the realm of whether there is an *obligation* to act in good faith when in a contractual relationship. The case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 ('***Renard Constructions***') is a seminal case that 'started' this important discussion of 'good faith'.

This newsletter will note how this case has articulated and emphasised the notion of good faith, and how this discussion has been followed (or challenged) in courts of different jurisdictions. While the High Court of Australia is yet to rule on the nature and content of the obligation of good faith,[1] noting that (at least in courts of New South Wales) there is a substantial number of cases that have expressed support for the finding of good faith following *Renard Constructions*, it seems prudent to assume that there *is* an obligation to act in good faith. We will also dedicate a section to discuss the role and operation of the duty of good faith in situations involving show cause notices.

# Facts

The Minister for Public Works ('**the Principal**') was in a contractual relationship (under two contracts) with Renard Constructions (ME) Pty Ltd ('**the Contractor**') for the construction of pumping stations as part of a sewerage project in the Gosford/Wyong area.

Clause 44.1 of the contracts provided a mechanism by which the Principal was required to give the Contractor a notice to show cause as to why the Principal should not take over the work from the Contractor or cancel the contract, in case of default by the Contractor. If the Principal did not accept the Contractor's response, the Contractor was entitled to refer the matter to arbitration.[2]

The show cause notice was given by the Principal to the Contractor after delays occurred, and the Contractor responded, indicating that the Principal did not yet

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[1] Kevin Arkwright and Jeffrey Goldberger, 'Good faith and the exercise of contractual discretions, *Norton Rose Fulbright – Publications* (online, March 2020) <https://www.nortonrosefulbright.com/en/knowledge/publications/9f67407c/good-faith-and-the-exercise-of-contractual-discretions>.

[2] As explained by Basten AJA in *United Petroleum Pty Ltd v Coastal Services Centres Pty Ltd* [2024] NSWCA 97, [67].

supply the required materials as per the Contract and that the work would be completed after they were supplied.

When further delays occurred, the Superintendent to the contracts recommended cancellation of both contracts, being not fully informed of the relevant circumstances by the Principal, and the Principal took over the remaining works.

The matter was referred to arbitration, to the Supreme Court and was eventually appealed in the New South Wales Court of Appeal on the grounds that the Principal was *unreasonable* in exercising its power to take over the work.

## Decision

The Court of Appeal construed Clause 44.1 as requiring the Principal to act reasonably and honestly in deciding whether or not to exercise the power to take over the works pursuant to the contracts – thus in deciding whether the Contractor had failed to show cause.

The Court of Appeal importantly considered that the duty of *good faith* was a relevant consideration of reasonableness.

## Judgment and other commentaries

The discussion of 'good faith' is most evident and pertinent in Priestly JA's portion of the judgment.

Priestly JA emphatically addressed the application of the duty of good faith and fair dealing at 268 of the judgment, whereupon he stated:

> '*... that people generally, including judges and other lawyers, from all strands of the community, have grown used to the* ***courts applying standards of fairness to contract*** *which are wholly consistent with the existence in all contracts of a* ***duty upon the parties of good faith and fair dealing*** *in its performance. In my view this is in these days* ***the expected standard****, and anything less is contrary to prevailing community expectations.*'

This was agreed by other members of the Court, being Meagher and Handley JJA.[3]

In the extracted paragraph above, Priestly JA makes it clear that the existence of the duty of good faith is something that has increasingly been recognised and applied by the courts. Priestly JA also expresses that this must be the norm, the 'expected standard', in contractual relationships.

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[3] *Burger King Corporation v Hungry Jack's Pty Limited* (2001) 69 NSWLR 558; [2001] NSWCA 187, [153].

Importantly, in forming this view, Priestly JA took into account the *Uniform Commercial code* (1951) and its subsequent formulation in the *Restatement (Second) of Contract* (1981) and the influence they had on American case law.[4] Accordingly at 268, Priestly JA stated that there were convincing arguments '*for the recognition in Australia of [such a] duty*'.

It is worth noting that Priestly JA did not (nor any other justices in the case) define nor stipulate the requirement(s) for 'good faith'. Instead, he expressed that 'good faith' overlaps with the notion of 'reasonableness'. At 263, Priestly JA stated:

> '*... the kind of reasonableness I have been discussing seems to me to have much in common with the notions of good faith*.'

Expanding on this, Priestly JA continued at 265 that:

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

## *Subsequent developments*

Subsequent cases following *Renard Constructions* helpfully elaborated further on the meaning of good faith, with some affirming the judgment laid out by Priestly JA.

The Court in *Burger King Corporation v Hungry Jacks Pty Ltd* (2001) 69 NSWLR 558 affirmed Priestly JA's recognition of the lack of distinction between reasonableness and good faith, stating at paragraph 169 that:

> '[169] ... *it is worth noting that the Australian cases make* ***no distinction of substance*** *between the implied term of reasonableness and that of good faith.*'

In the same case, the Court noted the judgment in *Alcatel Australia Ltd v Scarcella & Ors* (1998) 44 NSWLR 349 by Sheller JA at paragraph 171:

> '[171] ... *In addition to his [Sheller JA] references to Renard, Sheller JA referred to the statement of Sir Anthony Mason in his 1993 Cambridge Lecture, that it was probable that the concept of good faith "embraced no less than three related notions":*
>
> *(1) an obligation on the parties to* ***co-operate*** *in achieving the contractual objects (loyalty to the promise itself);*
> *(2) compliance with* ***honest*** *standards of conduct; and*

[4] See *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558; [2001] NSWCA 187, [147]. [149].

> *(3) compliance with standards of contract which are **reasonable** having regard to the interests of the parties.*'

Continuing at paragraph 172, the Court noted Finkelstein J's expression in paragraph 37 of the Federal Court case, *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* [1999] FCA 903:

> '[172] *In Garry Rogers, Finkelstein J considered... that such a term imposed an obligation on a party "**not to act capriciously**". He pointed out, however, that such a term will not restrict a party acting so as to promote his own "legitimate interests". As his Honour explained, "provided the party exercising the power **acts reasonably** in all the circumstances the duty to act fairly and in good faith will ordinarily be satisfied.*'

While helpful that notions such as co-operation and honesty are relevant considerations for 'good faith', the understanding of 'good faith' still remains rather unclear and not definitively articulated. It remains a complex concept, as it continues to be associated with, without a clear distinguishing feature, the idea of 'reasonableness'. It may even be argued that permitting one to act in their own legitimate interests blurs or may be inconsistent with the idea of 'good faith'.

***Good faith – not required?***

Almost in opposition to Priestly JA, the Warren CJ in *Esso Australia Resources v Southern Pacific Petroleum* [2005] VSCA 228 was *not* prepared to find that the duty of good faith must be implied to any and every contractual relationship.

Warren CJ criticised that the standard 'good faith' imposes is nebulous, and was of the view that it should apply only when there is an imbalance of power in the contractual parties; when one is at a 'substantial disadvantage' compared to the other. At paragraph [3]-[4] of his judgment, Warren CJ stated:

> '[3] ... If a duty of good faith exists, it really means that there is a standard of contractual conduct that should be met. The difficulty is that the standard is **nebulous**. Therefore, the current reticence attending the application and recognition of a duty of good faith probably **lies as much with the vagueness and imprecision inherent in defining commercial morality**. The modern law of contract has developed on the premise of achieving certainty in commerce. If good faith is not readily capable of definition then that certainty is undermined. **It might be that a duty of good faith is no more than a duty to act reasonably in performance and enforcement**, a long established duty. Of course, some commentators have regarded the duty to act reasonably as properly subsumed within the duty of good faith.
>
> [4] Ultimately, the interests of certainty in contractual activity should be **interfered with only when the relationship between the parties is unbalanced and one party is at a substantial disadvantage, or is**

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

Interestingly, Buchanan JA in the other hand seemingly *accepted* the judicial discussion and elaboration of 'good faith', and subsequently applied them in the present case. At paragraph [38] he stated:

> '[38] The content of an implied contractual duty of good faith has been variously described. In *Renard* Priestly JA equated good faith with reasonableness. In *Garry Rogers* Finkelstein, J. said that an obligation of good faith required a party "not to act capriciously". Breach of the obligation has been described as seeking to prevent the performance of the contract or withholding its benefits and as seeking to further an ulterior purpose or purpose extraneous to that for which a right or power is conferred. In my opinion the provision is the proposed deed of arrangement for the winding up of SPP is not unreasonable, capricious or the pursuit of an ulterior purpose and did not prevent the performance of the contract or deny Esso its benefits.'

Osborn AJA agreed with Buchanan JA in his judgment.

Therefore, it may be said that there was more *support* for the view that duty of good faith is implied to contractual relationships, although it would be relevant to note that the Chief Justice of this Court had a different view.

Regardless, as a whole, it is interesting to see how different justices have different opinions on whether a duty of good faith can or should be implied in contractual settings. It is perhaps correlated to the fact that the duty of good faith has not of yet been clearly nor comprehensively explained, making it difficult for the judges *themselves* to conceptualise and apply the concept.

## Application: Good faith and show cause notices

Specifically in the context of show cause notices, the decision in *Renard* informs us that the Principal, as someone who issues the show cause notice, must act in good faith in considering the Contractor's response to the notice, and therefore in deciding whether the work should be taken over the Contractor.

In the recent case of *Bundanoon Sandstone Pty Ltd v Cenric Group Pty Ltd* [2019] NSWCA 87, the NSW Court of Appeal likewise held that the Principal must act in

good faith in considering the Contractor's response to a show cause notice. One commentary of this case also stated:

> 'In circumstances where a principal had a closed mind and was not interested in the content of the response, the principal's subsequent termination of the contract constituted a wrongful repudiation. The NSW Court of Appeal noted that the principal's real motive in initiating the show cause process was to deprive the contractor of a specific economic benefit and take that benefit for itself.'[5]

We therefore see that the duty of good faith is *inherently* 'attracted' or must be exercised in the context of show cause notices, because it requires the Principal to assess the Contractor's response and decide whether to take over the works accordingly. Therefore, it is important that the Principal's judgment in reaching the decision is not exercised dishonesty and capriciously.

In situations where the Principal complains of matters that were in the fault of the Principal, this may indicate (depending on the circumstances) that the Principal either (a) did not pay attention nor had sufficient regard to the content of the Contractor's response, or (b) is acting dishonestly by trying to shift the blame to the Contractor when it is, in actuality, the Principal's fault. Consequently, there could be (again, subject to careful evaluation and analysis of the factual circumstances) a legitimate argument or finding *against* good faith in these situations. While there does not seem to be case laws that have dealt with this situation yet, given the judicial elaboration on the duty of good faith (as discussed in the above sections), it would be prudent to assume that it is likely *contrary* to the duty of good faith for the Principal to complain of matters that were not the Contractor's fault (and are rather his/her own fault).

## *Renard*'s importance and relevance

The case *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 is important because it informs the courts' gradual willingness to recognise the duty of good faith as a concept that should be implied into contracts. The case specifically concerned the Principal taking over the works with respect to a show cause notice, but the duty of good faith is not limited to these situations only.

Courts (both in and subsequent to the *Renard* case) have discussed the duty of good faith in a general sense, giving it a broad explanation that, inter alia, (a) it embraces notions of co-operation and honesty, (b) is not materially

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[5] Kevin Arkwright and Jeffrey Goldberger, 'Good faith and the exercise of contractual discretions' (online, March 2020) < https://www.nortonrosefulbright.com/en/knowledge/publications/9f67407c/good-faith-and-the-exercise-of-contractual-discretions#:~:text=In%20the%20recent%20decision%20of,faith%20in%20considering%20the%20contractor's>.

distinguishable from reasonableness, and (c) it requires a party not to act capriciously.

Therefore, readers must be prepared to accept or anticipate that (especially if they are in or about to enter into a contractual relationship) they are likely to have a duty to act in good faith. They must therefore be wary and cautious of whether their actions under the contract are contrary to good faith, evaluating whether their actions are, for instance, dishonest or do not demonstrate co-operation.

In particular, readers should be mindful (whether they are the Principal or the Contractor in their respective contracts) of the impact the duty of good faith has in situations involving show cause notices. This newsletter encourages the readers to pay specific attention to whether the Principal is exercising or has exercised good faith in assessing the Contractor's response to the show cause notice, should those situations arise.

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