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Good Faith - Time to Put the Genie Back in the Bottle

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Abstract

In this paper, we examine the doctrine of good faith contractual performance in the context of the Australian law of contract. We argue that the doctrine as presently developed has taken on chimerical qualities and in particular, represents an undesirable threat to commercial certainty. In justifying our position, we use the recent decision of the NSW Court of Appeal in Vodafone v Mobile Innovations as a case study of the dangers associated with invoking good faith as a means of interfering with the essence of a bargain struck between commercial parties.

1 Introduction

It now appears to be generally accepted that the good faith in contractual performance genie was let out of the bottle in Australia in 1992, as a result of Priestley JA’s decision in Renard Constructions (ME) Pty Ltd v Minister for Public Works. Much has been written about that decision and it is not necessary or desirable to re-traverse that territory in the context of this article. Neither however, having acknowledged the substantial impact on the development of Australian contract jurisprudence wrought by the publication of Justice Priestley’s reasons in Renard, is it appropriate to take the view that good faith was cemented into the Australian framework for contract law merely because of that decision.

Writing in 1999, Professor Harland opined that at that time the Australian law did not recognise a general duty of good faith in the performance and enforcement of contracts analogous to that contemplated by Priestley JA in Renard. Notwithstanding their persistent interest in the good faith issue since that time, Australian courts appear little closer to resolving important questions as to the situations in which a good faith obligation will be found to be operative, the content of such an obligation will be found to be operative, the content of such an obligation and, importantly, the degree to which the express terms of an agreement reached by commercial parties might exclude the operation of the good faith doctrine, given the current penchant for courts to infuse the obligation for good faith performance via the implication of terms.

This article proceeds as follows. In section two, we briefly review the approach taken to the good faith issue in the academic literature and a variety of Australian cases and argue that, far from revealing the growth of a cogent principled and workable construct, the extant Australian case law evidences substantial confusion. Given that the smog of this confusion lies over perhaps the most important commercial legal tool, the contract, we suggest that this is a worrying development indeed.

To demonstrate why this is so in a more concrete sense in section three of the paper we provide a detailed case study of a situation in which good faith collided with good sense, arguably to the detriment of all parties to the dispute. Section four of the paper examines the response of the New South Wales Supreme Court at first instance and then the New South Wales Court of Appeal to the dispute. Finally, in section five of the paper we offer our overall conclusions and some thoughts on a way forward for the Australian law of contract.

2. The Burgeoning Imbroglio

When Justice Priestley penned his statements in favour of the adoption of a good faith contractual performance standard in Renard, he had the benefit of a considerable body of international jurisprudence and scholarship on the subject. One of the clear lessons to be drawn from that considerable corpus of knowledge, obviously salient to his honour at the time he produced his reasons in Renard, was the ongoing controversy about the meaning and content of a requirement that parties to commercial contracts perform their obligations and exercise their rights in good faith.

Evidently this did not trouble Priestley JA greatly, for in his reasons he noted, almost casually, his preference for one particular approach to defining good faith, the famous “good faith as a bad faith excluder” construct usually attributed to Professor Summers. Under this approach, as Priestley JA notes, the concept of good faith has no particular general meaning of its own, but rather, serves to exclude the intrusion of a variety of forms of bad faith into contractual relations.

One obvious retort to the definitional approach suggested above is that while it removes the difficulty associated with conclusively defining good faith, it simultaneously creates a problem of at least the same magnitude in the sense that it is now necessary to define behaviour which falls into the catchall
category of “bad faith” in its nature.

Unsurprisingly then, a review of the literature on the subject reveals a wide array of apparently conflicting definitional approaches to the good faith question. One of the earliest formulations of a good faith performance duty was articulated by the New York Court of Appeals in *Kirke La Shelle Co. v Paul Armstrong Co*3. In that case, the Court held that “in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.”10 This approach has been criticised on the grounds that it focuses on the benefit to be received under a contract by the promisee, but fails to place focus on the issue of discretion in the performance of a contract11. Hardly surprisingly therefore, some analysts have taken the view that the appropriate focus of a good faith performance obligation revolves around interrogation of the manner in which discretions conferred on parties to contracts are exercised. Accordingly, the leading exponent of this approach, Professor Burton, argues that good faith performance occurs when a party’s discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation12.

Some authors have taken the position that the idea of good faith embodies concepts of a broadly moral nature, drawing upon standards of fairness and cooperation13. This approach is invariably criticised for being too vague and producing a risk of uncertain results14. A further counterpoint to the approaches to good faith set out above may be found in certain of the extra curial writings of Sir Anthony Mason. In an influential article, Sir Anthony suggested that good faith can be said to embrace three key intertwined notions. The first of these was that parties to contracts are obligated to demonstrate a requirement of reasonable conduct, having regard to the interests of the parties15.

While few would take pains to question the honesty requirement, the insertion of a reasonableness requirement is problematic in the sense that it is not clear the extent to which this would require the subordination of one party’s interests to another, particularly in relation to the exercise of contractual discretions. Perhaps this explains the approach taken by a contemporary Australian commentator, Elisabeth Peden, who argues that the essence of the good faith requirement is a requirement to behave with honesty and with regard to the interests of the other party but without a requirement that one’s own interests be subordinated16.

Given the discord evident in the discussion above, it is hardly surprising that decisions of Australian courts in relation to the good faith in contractual performance issue also demonstrate considerable variation in approach. Though within the confined scope of this paper it is not possible to provide a comprehensive review of definitional approaches to good faith performance adopted by Australian courts, it is nonetheless possible to make some generally useful observations in relation to this matter. One key observation is that the decisions which purport to deal with good faith demonstrate a growing tendency to merge the terms “reasonable”, “good faith” and “fair dealing” as if they are homogenous in meaning and content.

In *Hughes Aircraft Systems*18, a prominent case in which the issue of implied terms requiring good faith performance arose, Finn J commenced his discussion of implied terms using the label “good faith”, but fell largely into references to “fair dealing” thereafter. Arguably the former is more subjective in its content, and the latter more objective. Certainly there seems no reason to equate the two. Yet many of Finn J’s reasons for suggesting the existence of an implied term requiring good faith performance were founded on the assertion that fair dealing is an expected facet of business interaction in the present climate. That may be so, but whether it logically follows that one may be conjured by invoking the other is a separate question. All of the above suggests that though declaring the existence of some form of duty to be implied into each contract to perform in good faith may not at present be viewed as problematic, at least by some judges in some jurisdictions, there are chronic difficulties in defining the content and meaning of such a duty.

Thus, cases such as *Alcatel Australia Limited v Scarcella & Ors*19 and *Garry Rogers Motors v Subaru (Aust) Pty Ltd*20 appear to fall into the trap of equating reasonableness with good faith. Both of these cases cite Renard as authority for the existence of an implied term requiring good faith, when viewed with precision Renard is only authority for the notion that a principal should exercise powers conferred by a contract reasonably21. Further, there seems to be confusion as to whether good faith will be demonstrated by the absence of bad faith22, or by the commission of reasonable acts23.

Most recently, courts in some jurisdictions appear to have accepted that at least for the moment, no clarification of this matter is likely, and have therefore attempted to resolve questions put before them with reference to multiple constructions of the concepts of good faith and reasonableness24, something of a scattergun approach to the problem. The consequence of this lack of clarity is that decision makers have been somewhat hamstrung by an inability to define precisely whether the standard of behaviour required of contracting parties is one of “reasonableness” or “good faith” or perhaps both25. We may be at a point where there is begrudging acceptance of the existence of some form of doctrine or other, but recent cases suggest that there is a good deal of confusion as to the content and meaning of that doctrine26.

3. A Hard Headed Bargain

Though the potential confusion wrought by the emergence and growth of the good faith performance doctrine in the Australian law of contract has been evident in a significant number of decided cases, it is particularly well illustrated in the recent case of *Vodafone Pacific v Mobile Innovations Ltd*27. This case was an appeal resulting from the decision of Einstein J in the NSW Supreme Court in *Mobile Innovations Ltd v Vodafone Pacific Ltd*28. The appellant, Vodafone Pacific Ltd (henceforth Vodafone) was established to own and operate a mobile telephone network in Australia during the early 1990s. The respondent, Mobile Innovations Ltd (henceforth Mobile Innovations) had originally (from around 1994) been in the business of purchasing airtime from Vodafone and on selling that airtime to its own customer base with a view to a profit.

In October 1998, the business relationship between
Mobile Innovations contracted with Vodafone to provide two forms of service. First, Mobile Innovations was engaged by Vodafone as a direct marketing agent. In this guise, Mobile Innovations would attempt to acquire new customers and have them connected to the Vodafone network. Second, Mobile Innovations was to provide management services in relation to pre-existing and newly acquired Vodafone subscribers.

By the conclusion of the 1998 financial year, Mobile Innovations had a customer base of approximately 60,000 subscribers. This grew to 100,000 by June 1999, 120,000 by June 2000 and 180,000 by June 2001. The company's financial performance directly reflected this growth. In 1998, the first year of its revised contractual arrangement with Vodafone, Mobile Innovations recorded a before tax loss of AUD $165,000. In 1999, the company's before tax profit grew to AUD $4 million and then to AUD $4.7 million in the year ended June 30 2000. Still further growth in profitability was evident with the release of the June 30 2001 accounts, which revealed that Mobile Innovations had earned a full year before tax profit of AUD $5.2 million.

The profit and loss data reported by Mobile Innovations is instructive for two reasons. First, the only material source of revenue (and thus profit) enjoyed by the organisation during the period under review derived from the service provider contract put in place between Vodafone and Mobile Innovations in October 1998. That this is so demonstrates that the contractual arrangement between the two organisations was a particularly financially lucrative one for Mobile Innovations. Second, a review of profit and loss data pertaining to Vodafone reveals that over approximately the same timeframe, Vodafone was suffering significant losses. Financially then, even in the early stages of what was to be a ten year agreement, clear asymmetries had appeared between the parties.

The contractual incentives facing Mobile Innovations were as stark as they were simple. More acquired customers meant more cashflows. There are three reasons for this. First, in respect of each new customer acquired, the contract which subsisted between Mobile Innovations and Vodafone specified that a sum known as a “base acquisition margin” (BAM) be paid. This amount varied according to the number of subscribers connected during a given month, but was calculated in such a way that incremental customer acquisitions would always result in incremental gross base acquisition margin cashflows accruing to Mobile Innovations.

Second, in addition to the base acquisition margins, Mobile Innovations was compensated by Vodafone for the costs it incurred in acquiring new customers. Again, these costs varied from quarter to quarter. Finally, Mobile Innovations was paid a monthly management fee, initially set at $7 per subscriber per month. This fee would continue to be paid for such period of time as a customer acquired by Mobile Innovations continued to subscribe to Vodafone telecommunications services. In summary therefore, upon acquiring a customer, Mobile Innovations would be compensated for its direct acquisitions costs, paid a sum unrelated to its acquisition costs as a financial bonus for enlarging Vodafone’s subscriber base and then paid a trailing cashflow for the remainder of the period of the customer relationship in return for management services provided during that time.

Taken together, the following observations seem pertinent. First, for Mobile Innovations, volume was king. Under the original version of the service contract between the two organisations, Mobile Innovations had no incentive to be discriminating in terms of the quality of customers it attempted to attract. In short, customer profitability was not its problem.

Second, the service agreement negotiated between Vodafone and Mobile Innovations provided Mobile Innovations with few incentives to strictly control customer acquisitions costs. Each quarter, the parties to the agreement would formulate a worksheet in which an estimated per customer acquisition cost was derived, having regard to factors such as the different products to be promoted, handset and other sales related subsidies to be provided, sales commissions to be paid, allocations of overhead and other pertinent variables. Though the derivation of the final estimated cost to acquire appears ultimately to have been subject to a process of negotiation (thus suggesting that Vodafone retained some capacity to control this stream of costs), problems still remained. It is particularly noteworthy that the agreed quarterly cost to acquire included an allocation of Mobile Innovation’s overheads attributable to carrying out acquisition activities. Viewed at a practical level this poses problems not only because overheads by their nature tend to be indirect rather than direct costs, but also because overhead allocation processes can be fraught with difficulty and inaccuracy. In light of this, it seems entirely likely that there was room for gaming in relation to the derivation of customer acquisition cost estimates, and that this room was, from time to time, exploited.

Third, since direct acquisitions costs were funded by Vodafone and since the BAM payments were relatively large in magnitude when compared with the trailing monthly management fees and, unlike the trailing monthly management fees had essentially no relationship to incurred business costs (that is, essentially represented pure profit), Mobile Innovations likely also had incentives to “churn” the customer base on a regular basis. Essentially, it is not difficult to contemplate scenarios in which Mobile Innovations would be more greatly enriched by encouraging the development of a more volatile customer portfolio.

In short, irrespective of the good will each party may have initially brought to the business relationship, the contract which fused them together in a formal sense also opened the way for calculated opportunism leading to asymmetric operational and financial results. Evidently it did not take long for fissures in the relationship to begin to open. Only eight months after the parties executed their ten year agent service provider contract, in May 1999, the parties saw fit to amend its original terms by specifying that Vodafone would from that point onwards pay a lower monthly management fee in relation to subscribers acquired by Mobile Innovations on low tariff plans.

That this form of amendment was pursued so soon after the formation of the contract speaks volumes about the tangibility of the risk of opportunistic behaviour within the boundaries of the agreement. Although no specific commentary in relation to the motivation for the May 1999 amendment was offered by Justice Einstein in his original decision or by those who
presided over the appeal, it does not seem too rash to speculate that Mobile Innovations was effectively flooding Vodafone with high volumes of low value subscribers even from the earliest days of their business relationship. Nor does it seem rash to opine that as each additional low value subscriber was funnelled onto Vodafone’s network as a result of the marketing initiatives undertaken by Mobile Innovations, Vodafone’s losses mounted. Mobile Innovations’ road to financial nirvana soon looked to Vodafone like its road to perdition.

Despite the foregoing, this is a tale about forethought rather than naivety. Although undertaking a key business process through the agency of an external actor carries a series of risks which would be mitigated were the activities to be internalised, and though the fact of the dispute between the parties suggests that the crystallisation of just such risks became so chronic a problem that radical action was required, Vodafone did not embark on its relationship with Mobile Innovations without reserving a very important pressure valve for itself. That device came in the form of a combination of clauses within the agent service provider contract pursuant to which Vodafone reserved the right to limit the extent of the agreement it had with Mobile Innovations to the four corners of the written instrument and to exercise a very high degree of discretion in providing targets and directions to Mobile Innovations, and generally in relation to its execution of its obligations under the contract.

Four clauses of the agent service provider agreement in particular are worthy of individual attention. First, clause 18.4, which stipulated that Vodafone was to have the sole discretion to determine the target levels for new subscribers it provided to Mobile Innovations from time to time. Second, Clause 24 which purported to the full extent permitted by law to exclude all implied terms conditions and warranties. Third, clause 41 which provided in cases where the agreement allowed Vodafone to exercise any discretion, it was to be able to exercise that discretion in any manner it saw fit. Fourth and finally, clause 44 which provided that the written contract contained the entire agreement between the parties. These were the defence mechanisms of final resort, embedded into the contract formed between the two parties as an insurance policy for Vodafone in the event that they were required. And when Vodafone reached the conclusion that the time had come to turn off the tap to prevent a further flood of unprofitable customers emanating from the Mobile Innovations faucet, it was to the authority it believed it held pursuant to the above clauses that it turned in acting to protect its commercial interests.

Though the agreement between the parties was complex and highly detailed, its essence may be grasped with considerable facility. The amount of revenue which Mobile Innovations was expending by way of direct acquisition cost reimbursement and BAM payments via the simple expedient of radically reducing the targeted level of customers to be acquired by Mobile Innovations. As events transpired, Vodafone ultimately chose to reframe its situation with respect to Mobile Innovations by setting the customer acquisition target to nil. Importantly, due to the manner in which the contract was framed, it was not feasible for Mobile Innovations to simply ignore the volume targets set by Vodafone and continue to arrange for the connection of large numbers of new subscribers. Once Vodafone set a nil customer acquisition target, the business of Mobile Innovations was effectively forced into run-off mode. Mobile innovations would continue to provide day to day management services in respect of a customer portfolio dwindling rapidly in size as a result of customer churn and cancellation with no new replacement customers able to be added to the mix.

4. The Legal Proceedings

In the wake of the breakdown of the relationship between the parties which resulted from Vodafone’s application of a scorched earth approach to the rationalisation and reconfiguration of its business model, Mobile Innovations commenced legal proceedings seeking redress. Its pleadings, and those put in response by Vodafone were enormously complex and lengthy. For the purposes of this article however, the relevant issues can all be related back to the question of whether Vodafone was entitled to determine a connections target of nil, thus effectively stultifying the commercial relationship which had subsisted between the parties to that point and to the extent to which the contract agreed between the parties could serve to resist the intrusion of implied terms.

In the original case between the parties heard by Justice J in the Supreme Court of NSW, Mobile Innovations was substantially successful in proving that Vodafone’s actions had been in breach of its contractual obligations. In consequence, it was awarded damages amounting to approximately AUD $14.3 million dollars. The good faith doctrine loomed large in assisting the court to reach its determination.

In pondering the existence of an implied term requiring good faith performance, Justice Einstein held that “as a general proposition, the current state of the law in New South Wales is that there will usually be implied by law into commercial contracts made between parties at arms length, a term requiring the exercise of good faith in the performance of such contracts” [613]. Further, in contemplating the nature of such an implied term, his Honour explored a number of current propositions that in his opinion could be derived from contemporary Australian cases touching on good faith. These included:

a) An obligation to behave honestly and to do all such things as are necessary to enable the other party to have the benefit of the contract are elements of good faith.
b) Australian authorities make no distinction between implied terms of ‘good faith’ and ‘reasonableness’

c) The implied term does not require one party to subordinate its own interests to the other party’s

Contemplating these matters and the facts before him, Justice Einstein determined that implied terms requiring Vodafone to act in good faith and reasonably should in fact be implied into the contract between it and Mobile Innovations, despite the fact that the black letter of the contract purported to exclude the implication of such terms.

Whilst the existence of such a term was apparently easily recognised, however, the more difficult question was as to the reach of the term. In discussing the extent to which an implied term of good faith could bind Vodafone, Justice Einstein adopted a cautious tone. The implication of a good faith or reasonableness term which would oblige Vodafone to put forward by way of a target a particular positive number of new subscribers that was reasonably expected was deemed to be an impermissible interference with the express provisions of the agent service provider agreement between the two parties.

To do so, Justice Einstein cautioned, would represent a situation in which courts found themselves “spell[ing] out what the parties have for themselves failed to agree upon”. The judgment emphasises the reality of commercial transactions, and the difficulty of implying a term of good faith between parties who have opposing interests. In order to be profitable, Vodafone had to derive revenue which exceeded the costs of acquiring and maintaining the customers, thus it was in Vodafone’s interests to carefully monitor the number of new subscribers and the time periods for which they signed up.

In contrast, as discussed in detail above, Mobile Innovations was paid by reference to an acquisition fee as well as a management fee giving it an incentive structure geared essentially to volume. In contemplating the application of notions of reasonableness in such settings, Justice Einstein cautions that reasonableness is difficult to determine in any event, but is made even more difficult when dealing with businessmen and companies in a competitive market environment, where the interests of each party are diametrically opposed.

Despite this expression of caution, Einstein J’s reasons go on to state that “this is not however to suggest that the implied obligations of good faith and reasonableness would not be breached if shown to have been exercised arbitrarily or capriciously”. It would appear that in this case a factor highly influential in determining the outcome was the attitude Einstein J took to the change of Vodafone’s strategy in the context of what had commenced as a putatively long term contractual relationship, such that its commercial objectives were no longer consistent with the contract. In consequence, the court took the view that Vodafone’s conduct could be seen to have been in bad faith and thus inconsistent with that organisation’s contractual obligations.

Thus, where the judgment stops short of implying a term that would require Vodafone to put forward a particular positive target subscriber number that was reasonably expected, it nonetheless held that the implied term of cooperation (and presumably good faith) would require Vodafone to put forward at least some sort of positive number. In Einstein J’s view, Vodafone’s determination of a nil target for customer acquisitions therefore represented, of itself, a breach of the implied term requiring reasonableness and good faith in contractual performance.

In summary therefore, in the wake of the first bout of litigation between the antagonists, Vodafone found itself in the following position. First, it was not possible (at least in the facts of the instant case) to avoid the implication of a term requiring good faith performance even in the presence of express clauses purporting to have that effect. Second, the court implied a term requiring Vodafone to act in good faith or reasonably in its performance of its contractual obligations. Finally, in setting nil acquisitions targets, Vodafone was found to have breached this term. It followed that Vodafone had breached the agreement and substantial damages were in consequence awarded to Mobile Innovations.

Unsurprisingly, Vodafone appealed. On appeal it was held that a term requiring good faith and reasonableness in the performance of a contractual power may be implied as a matter of law as a legal incident of a commercial contract. However, the Court of Appeal found that Justice Einstein’s original reasoning relating to the existence of good faith obligations, their content and the extent to which Vodafone’s conduct represented breaches of such obligations was flawed, and in consequence proposed an alternative form of legal analysis. The elements of that alternative enquiry relevant in the context of this article included an analysis of whether on the proper construction of the agreement between the parties Vodafone was entitled to determine a customer acquisition target level of nil and whether Vodafone was obliged by an implied term to act in good faith and reasonably in determining the target level it provided Mobile Innovations from time to time (and whether or not it so acted). As far as the NSW Court of Appeal was concerned, Vodafone was, on the proper construction of the agreement, entitled to set a target customer acquisition level at nil. That being so, it was not open to conclude that a breach of a good faith obligation (assuming the existence of such an obligation) had transpired merely due to the decision taken by Vodafone to set a target of nil. The question then arose as to whether implication of a term requiring good faith performance could be precluded by the express language of the agreement between the parties. The court expressed the strong view that given the commercial context of the dealings between the parties and the clear reservation of discretion in Vodafone’s favour embedded within the agreement, implication of a term requiring Vodafone to act in good faith and reasonably in the determination of subscriber target levels was indeed precluded by the express terms of the contract. As a consequence of these determinations, the outcome of the appeal was in most respects the opposite of the outcome in the original trial and the substantial damages which had been awarded against Vodafone at first instance evaporated.

5. Some Concluding Ruminations

The contract which lay at the heart of the dispute which has evolved between Vodafone and Mobile Innovations was a detailed and, it seems reasonable to conclude, carefully crafted document. Considerable attention was paid within the document to issues which ultimately went to the management and apportionment of commercial risk. The black letter of the
contract was designed in such a way that it should have left no reader in doubt as to the boundaries of the agreement and the relative balance of power between the parties to it. The formation of the agreement was not vitiated by the existence of any species of fraud and nor ultimately was there any finding that the powers utilised by Vodafone pursuant to the agreement it had reached with Mobile Innovations had been exercised capriciously, arbitrarily or for any extraneous purpose.

Despite this, Justice Einstein found, at first instance, that Vodafone could not rely on the black letter of the contract. As a result, in determining where the boundaries of acceptable behaviour lay in attempting to reconfigure its exposure to an unprofitable marketplace, that organisation may well have been better off obtaining the services of a soothsayer than legal counsel. During the epic voyage one is forced to take in a bid to gain insight into his honour’s reasons for handing the victor’s laurels at first instance to Mobile Innovations the reader is becalmed in an apparently never ending though ill connected sea of facts, buffeted by a storm of construction at whose centre dance magically conjured apparitions of the parties’ intentions and ultimately swept away by boiling conflating waves of reasonableness, honesty and cooperation. Somewhere, in some distant memory lies certainty. Front and centre looms the spectre of good faith, arguably the root cause of the lacuna opened by Justice Einstein between the commercial reality of the dealings between Vodafone and Mobile Innovations, and the (initial) legal outcome.

It is true that this void was closed to a significant degree as a result of the decision by the NSW Court of Appeal to largely reverse the outcomes of the initial trial. By way of contrast to the approach taken by Justice Einstein in the original trial, Justice Ipp who wrote the unanimous judgment of the Court of Appeal paid forensic attention to the words of the bargain reached between the parties, and the commercial realities of the circumstances in which that bargain had been struck.

Whereas Justice Einstein had determined that on the proper construction of the agent service provider agreement Vodafone was not entitled to determine a target new subscriber level of zero, Justice Ipp held on appeal that given the clear language used in the agreement, there was nothing objectionable in allowing a target customer acquisition level of zero. Whereas in the first trial Justice Einstein had determined that the contract struck between Vodafone and Mobile Innovations could not preclude the implication of a term requiring good faith and reasonableness in performance, this was reversed on appeal.

Further, contrary to Justice Einstein’s findings in the original trial, it was held on appeal that even in the event that an implied term requiring good faith performance was implied into the contract which subsisted between Vodafone and Mobile Innovations, the operation of such a term would not extend so far as to require Vodafone to determine positive customer acquisition target levels, nor to requiring Vodafone to cooperate with Mobile Innovations.

While the NSW Court of Appeal’s decision in Vodafone v Mobile Innovations represents a welcome swing of the compass back towards commercial common sense and certainty, much remains to be done before it is possible to sigh in relief that the good faith genie has indeed been firmly placed back in the bottle. The Court of Appeal chose not, for example, to engage in debate as to whether or not a term implying good faith would be implied as a legal incident of commercial contracts, simply adopting the now familiar expedient of assuming for the sake of argument that such a term may be implied.

Further, though it was found on appeal that it was indeed possible for the implication of a term requiring good faith and reasonableness in contractual performance to be precluded as a result of the operation of the express terms of the contract, no clear principles were set out as to how contracts might in future be configured to avoid unwanted implication. It is also unfortunate that despite the Court of Appeal’s clear diffidence to the continued conflation of terms such as good faith and reasonableness, nothing in Justice Ipp’s reasons goes to the principled separation of such terms in future, though the extent of confusion which exists within the law as a result of continued reliance on mixed metaphors resonated through his words.

Thus while the direction taken in Vodafone v Mobile Innovations has arguably been a positive development, it has also demonstrated the continuing profound difficulty of breathing precise meaning into terms such as good faith, and distinguishing such terms from fellow travellers like reasonableness. It can hardly be lamented however, that this was a state of affairs entered into without warning. The fact that the literature on the topic of good faith demonstrates such remarkable schisms as to the very meaning of basic terms, and has done over an extended period, should have alerted all and sundry to the chance of such debates ultimately transplanting themselves from the journals to the law reports, with the types of severe consequences for commercial certainty demonstrated in Mobile Innovations v Vodafone. It is to be hoped that continued close attention to this issue by superior courts will in near future see the closing of this unfortunate chapter in Australian jurisprudence.


5. See for example; Far Horizons Pty Ltd v McDonalds Australia Ltd [2000] VSC 200; Burger King Corp v Hungry Jack’s Pty Ltd [2001] NSWCA 187; Apple Communications Ltd v Optus Mobile Pty Ltd [2001] NSWSC 635; GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd [2003] FCA 40.

6. See for example the remarks made by Priestley JA at (1992) 26 NSWLR 234 at 266.


10. 263 N.Y at 87, 188 N.E. at 167.


15. This is often referred to as a duty of cooperation.


22. This approach is favoured by Finkelstein J in Garry Rogers
generating significant profits at this point in time.

37. [2004] NSWCA 15 at [20].

38. The contract and in particular the financial provisions of the contract were complex. An overview of the key elements of the financial element of the contract can be found at [2004] NSWCA 15 at [74] - [90]

39. The amount stipulated was $40 for each of the first 8000 acquired customers in a particular month and $20 per newly acquired customer thereafter. See [2004] NSWCA 15 [81] - [82].

40. These costs may conveniently be described as customer acquisition costs.

41. See [2003] NSWSC 166 [49]; the quarterly per customer actual acquisition costs varied between $406.23 at the low end (March 1999 quarter) and $970.31 at the high end (September 2001 quarter).

42. This was known as a CTM “Cost to Manage” fee. See; [2003] NSWSC 166 [37].

43. [2003] NSWSC 166 [37].

44. Known as the CTA (cost to acquire) worksheet. [2003] NSWSC 166 [37].

45. [2003] NSWSC 166 [37].

46. [2004] NSWCA 15 [2].

47. [2003] NSWSC 166 [19].

48. Sheller, Giles and Ipp JJA.

49. Taking into account the high direct acquisitions costs, the base acquisition margins payable and the trailing management fees discussed above, extracting a profit from certain of the customers introduced by Mobile Innovations may well have represented a miraculous event. Consider a customer whose direct acquisition costs amounted to $450 and in relation to whom a base acquisition margin of $40 was paid. In addition, assume that a trailing management fee of $7 per month was paid in relation to the customer. In the first year during which the customer remained connected, the total amount which Vodafone would have paid Mobile Innovations would sum to $574. Over a two year relationship the costs to acquire and manage would total $450 + $40 + [24 x 7] = $658. Gilmour (2001) estimates average revenue per user of approximately AUD $600 for Australian mobile telephone subscribers. He also estimates average monthly churn rates at approximately 2.5% and average monthly cancellation rates at 1.4%. (Churn represents a situation in which a customer of one provider switches to an alternative provider). Taken together, the following scenario is possible. At industry averages, customer loss / turnover would equate to approximately 4% per month, or 48% per year. This means that across the entire customer portfolio, a customer relationship will on average last for approximately 2 years. On average, $1200 of gross revenue will have been generated by the average customer during this time. However, given the acquisition costs / costs to manage set out above, $658 will have been expended on acquisition and direct management costs over the same period. This leaves approximately $542 in revenue from which to cover

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all other business costs and yield a profit. It is by no means certain that this will be sufficient, and indeed, the fact that Vodafone’s operations were reported to be in loss during the period under consideration suggests that this residual revenue was entirely insufficient to yield a profit. On the other hand, as discussed above, the operations of Mobile Innovations yielded a considerable profit to that organisation.

50. Of course, the decision to structure the direct marketing operations through Mobile Innovations rather than directly from within Vodafone must also have been judged to have the potential to confer significant benefits on Vodafone. These may have included greater task competence, lower cost, greater flexibility and a range of other potential benefits.

51. [2004] NSWCA 15 [83]
52. [2004] NSWCA 15 [94].
53. [2004] NSWCA 15 [96].

54. It was not open to Mobile Innovations to attempt to continue to derive significant streams of BAM revenue and acquisition cost reimbursement by simply ignoring the targets Vodafone set and demanding reimbursement for its efforts ex post. Other elements of the contract clearly conspired to produce a situation pursuant to which it would, as a matter of practicality, be necessary for Mobile Innovations to substantially conform to the directives pertaining to volumes of connections issued from time to time by Vodafone.

55. In particular, clause 17 of the contract which required Mobile Innovations to use best endeavours to ensure that estimated customer acquisitions costs during a particular quarter conformed as closely as possible to actual incurred customer acquisitions costs (which Vodafone would then reimburse). See [2004] NSWCA 15 [106] - [108].

56. The 2002 and 2003 annual reports issued by Mobile Innovations show precisely this pattern in relation to reported subscriber numbers.

57. See [2003] NSWSC 166 [26] - [101] for a summary of the pleadings made by each party to the dispute at first instance.

59. [2003] NSWSC 166 [613].
60. [2003] NSWSC 166 [693].
63. [2003] NSWSC 166 [691].
64. [2003] NSWSC 166 [116].
65. [2003] NSWSC 166 [692].
66. [2003] NSWSC 166 [716].

67. Note that as in other earlier cases, the terms good faith and reasonableness are not strongly distinguished from one another.

69. [2004] NSWCA 15 [125]. Nothing of an evaluative nature is written at this point in Ipp JA’s reasons.
70. See [2004] NSWCA 15 [138].
71. [2004] NSWCA 15 [172]. See also [2004] NSWCA 15 [182].
73. [2004] NSWSC 15 [209].
75. [2003] NSWSC 166
77. [2004] NSWSC 15 [198]. The court of appeal paid particular attention to the emphatic use of language in which both parties acknowledged that the sole powers of discretion lay with Vodafone. In contemplating the agreement, the court held that “.the ASP agreement could only work if, should it be necessary, one party or the other had the whip hand as to the acquisition of customers.” ([2004] NSWSC 15 [196]).
78. [2004] NSWSC 15 [208].
79. [2004] NSWCA 15 [191].
80. See for example [2004] NSWCA 15 [192].