

**ESSO AUSTRALIA RESOURCES v SOUTHERN PACIFIC PERTROLEUM
[2004] VSC 477**

Supreme Court of Victoria – 23 November 2004

FACTS

Esso Australia Resources (“Esso”) and Southern Pacific Petroleum Pty Ltd (“SPP”) formed a joint venture to exploit mineral tenements near Gladstone in Queensland to produce shale oil. World oil prices fell after the agreement was made and Esso, as it was entitled to do under the joint venture agreement, deferred the work necessary to exploit the tenements. SPP experienced financial difficulty and an administrator was appointed to the company, who assigned SPP’s interest in the joint venture to another company as security for a loan, without the consent of Esso. Esso claimed that it must be consulted and it had a pre-emptive right to bid for the stake in the joint venture. That is, Esso claimed that SPP had evaded Esso’s consent and pre-emptive purchase right by insisting on the strict or “black letter” interpretation of the joint venture, which was in breach of its duty of good faith.

ISSUE

The content of the duty of good faith.

FINDING

The Court found that there was no lack of good faith or fair dealing in SPP acting to promote its own interests consistently with the basis on which it may be taken to have entered into the joint venture.

QUOTE

Hollingworth J said:

In assessing the standard of conduct required by a duty of good faith, courts have made reference to the ‘legitimate interests’ of the parties, or have suggested that good faith should prohibit a party from exercising a contractual power ‘capriciously’ or ‘for an extraneous purpose’... This approach entitles a party to engage in conduct which protects its own legitimate interests, but also requires consideration of the interests of the other party to the contract. By curtailing a party’s right to act self-interestedly in this way, good faith imposes a narrower and less onerous standard than that required of fiduciaries. The obvious question in this context is what amounts to a “legitimate interest”...The concept of “legitimate interests” does not have to refer to a party’s immediate commercial interest, but can be used to validate behaviour in the longer-term interest of one, or both, of the parties.

Hollingworth J continued:

Good faith can also be regarded, conceptually, as an obligation to refrain from acting in “bad faith”. This “excluder” approach was first articulated by Professor Summers, who identifies “bad faith” conduct as encompassing: evasion of the spirit of the deal, willful rendering of only substantial performance, abuse of a power to determine compliance, interference, and failure to cooperate in the other party’s performance. The excluder approach has received some Australian judicial support... However, whether it does anything to extend the definition of good faith beyond questions of reasonableness, legitimate interests and extraneous purposes is highly debatable.

IMPACT

This case stands for the proposition that the content of the duty of good faith encompasses two concepts:

- (1) prohibition of a party from exercising a contractual power capriciously or for an extraneous purpose, which entitles a party to engage in conduct which protects its own legitimate interests, but also requires consideration of the interests of the other party to the contract; and
- (2) the obligation to refrain from acting in “bad faith”, which may include evasion of the spirit of the deal, willful rendering of only substantial performance, abuse of a power to determine compliance, interference, and failure to cooperate in the other party’s performance.

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