

**ESSO AUSTRALIA RESOURCES v SOUTHERN PACIFIC PERTROLEUM
[2005] VSCA 228
Supreme Court of Victoria – 15 September 2005**

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

As Esso was not vulnerable and did not suffer a disadvantage, the Court dismissed Esso’s claim.

QUOTE

Warren CJ said:

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... 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. 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... 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.

Buchanan J said:

The content of an implied contractual duty of good faith has been variously described. In *Renard Priestley, J.A.* 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 in 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.

IMPACT

A party may breach its duty of good faith if it acts unreasonably, capriciously, or in the pursuit of an ulterior purpose. Further, a duty of good faith is likely only to arise where a party is vulnerable or at a disadvantage.

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