

**ALCATEL AUSTRALIA LIMITED v SCARCELLA & ORS
(1998) 44 NSWLR 349
Supreme Court of New South Wales – 16 July 1998**

FACTS

Francesco, Helen and Rocky Scarcella (“Scarcella”) owned premises at 276-280 Botany Road, Alexandria and leased the premises to Alcatel Australia Limited (“Alcatel”). Alcatel became interested in a proposal to build a seven-storey administrative building on the premises under a sale and lease back arrangement. The proposal was realised and leased back to Alcatel for the term of fifty years. Covenant 2(f) of the lease stated that Alcatel was to observe and perform all lawful requirements. Scarcella pressured the Council into imposing strict fire requirements on Alcatel requiring Alcatel to carry out substantial alterations to the staircase of the building. Alcatel refused to implement the fire requirements. Alcatel contended that it was not obliged to comply with covenant 2(f) of the lease as there was an implied term of good faith and reasonableness which bound Scarcella to ensure that Alcatel was not subjected to the expense and impact of an unreasonable fire order.

ISSUE

Whether there was an implied term of good faith and reasonableness.

FINDING

The Court found that a duty of good faith, both in performing obligations and exercising rights may, by implication, be imposed upon parties as part of a contract and that Scarcella had breached that duty.

QUOTE

Sheller JA (Powell and Beazley JJA agreeing) at 367 referred to Sir Anthony Mason’s 1993 Cambridge Lecture, who stated that he thought it 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
- (3) compliance with standards of contract which are reasonable having regard to the interests of the parties.

At 368 Sheller JA accepted that there could be an obligation of good faith implied into commercial contracts:

If a contract confers power on a contracting party in terms 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. Thus, a vendor may not be allowed to exercise a contractual power where it would be unconscionable in the circumstances to do so: *Pierce Bell Sales Pty Ltd v Frazer*.

Sheller JA concluded at 369:

The decisions in *Renard Constructions* and *Hughes Bros* mean that in New South Wales a duty of good faith, both in performing obligations and exercising rights, may by implication be imposed upon parties as part of a contract. There is no reason why such a duty should not be implied as part of this lease.

IMPACT

This case stands for the proposition that a duty of good faith, both in performing obligations and exercising rights may, by implication, be imposed upon parties as part of a contract. It extends to prohibit unreasonably encouraging third parties to improve obligations on the other contracting party for factual advantage.

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