



## FOOD AND GROCERY CODE OF CONDUCT REVIEW

### SUBMISSION TO TREASURY

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This submission addresses questions relating to provisions that employ the term 'good faith' in the Food and Grocery Code of Conduct (FGCC) and, in particular, the obligation on retailers and wholesalers to deal with suppliers in good faith pursuant to cl 28. Submissions relating to other aspects of the FGCC are reserved for response to the Interim Report of the Review.

The submission addresses the use of the term 'good faith' in the FGCC, the importance of the good faith obligation, the meaning of 'good faith' in the context of the obligation, the scope of the obligation, and the application of the obligation. In light of observations made in respect of these questions, it is submitted that the obligation be amended and a drafting proposal is provided.

#### **How is the term 'good faith' used in the provisions of the FGCC?**

1. The term 'good faith' is used in the following provisions in the FGCC:
  - cl 2(d): the Code's purpose to promote and support good faith in commercial dealings between retailers, wholesalers and suppliers;
  - cl 28: the obligation to deal lawfully and in good faith (**'the good faith obligation'**);
  - cl 34(2): the requirement that a retailer / wholesaler resolve a supplier's complaint that the supplier has requested be immediately elevated to senior management in good faith;
  - cl 37(4): the requirement that a retailer / wholesaler resolve a dispute that has been elevated on internal review in good faith;

- cl 38(3)(a): the requirement that a retailer / wholesaler take part in a mediation or arbitration in good faith;
- cl 38(5)(b): provision for a retailer / wholesaler not to take part in a mediation or arbitration if the mediator considers or the arbitrator determines that the supplier is not acting in good faith;
- cl 39(3)(b): identification of ways in which a retailer or wholesaler can be taken to be trying to resolve a dispute in good faith.

2. The focus of this submission is on the good faith obligation. The good faith obligation provides as follows:

**28 Obligation to deal lawfully and in good faith**

(1) The retailer or wholesaler must at all times deal with suppliers lawfully and in good faith within the meaning of the unwritten law as in force from time to time.

(2) The retailer or wholesaler must not enter into a grocery supply agreement that contains a provision that limits or excludes the obligation to act in good faith, and if it does, the provision has no effect.

(3) In determining whether the retailer or wholesaler has acted in good faith in dealing with a supplier, the following may be taken into account:

(a) whether the retailer or wholesaler's trading relationship with the supplier has been conducted without duress;

(b) whether the retailer or wholesaler's trading relationship with the supplier has been conducted in recognition of the need for certainty regarding the risks and costs of trading, particularly in relation to production, delivery and payment;

(c) whether, in dealing with the retailer or wholesaler, the supplier has acted in good faith.

(4) Subclause (3) does not limit subclause (1).

3. Given the number and range of provisions in which the term appears, we have considered whether a definition of the term 'good faith' should be included in the definitions clause of the Code (cl 3) and if so, whether that definition would apply to the term as it appears in all or some (and if so, which) provisions of the Code, and how the term should be defined.
4. We have formed the view that there should not be such a definition because there may be differences between the meaning of good faith in the context of dispute resolution and its meaning in the context of a substantive obligation. However, our recommendations regarding the scope of that obligation have some bearing on good faith in the context of dispute resolution (see points 22-25 below).
5. Moreover, we note that cl 39(3)(b) provides a useful prescription of the meaning of the obligation on a retailer or wholesaler to take part in a mediation or arbitration in good faith (cl 38(3)(a)).
6. We further note that there is no corresponding prescription as to the meaning of the obligations on a retailer or wholesaler to resolve a complaint that has been immediately elevated to senior management in good faith (cl 34(2)) and to resolve a complaint on internal review in good faith (cl 37(4)). We recommend that consideration be given to filling these gaps.

## Why is the good faith obligation important?

7. The good faith obligation is important because:
- (a) it is consistent with the nature of the general behavioural and cultural change that the FGCC aims to inculcate in dealings between retailers, wholesalers and suppliers and should facilitate education and more ready acceptance in the industry that good faith is a fundamental element of the trading relationship;
  - (b) correspondingly, it reinforces generally the purpose of the Code that relates to building and sustaining trust and cooperation (cl 2(a)) and reinforces specifically the purpose to promote and support good faith in commercial dealings between retailers, wholesalers and suppliers (cl 2(d));
  - (c) it serves as a check on the otherwise flexible nature of the obligations under the Code, such that in the event of uncertainty or disagreement between suppliers and retailers or wholesalers regarding the scope or meaning of another obligation, the good faith obligation acts as a back stop for suppliers, reinforcing the onus on the retailer or wholesaler to act in a way consistent with the purposes of the Code;
  - (d) it recognises that agreements between suppliers and retailers or wholesalers are relational contracts in which it is not possible or realistic to reduce every term of the trading relationship to a specifically defined contractual provision; there is a need to adjust the relationship over time to cater for unforeseen or unforeseeable factors; there are significant investments and commitments made by both parties; and there are elements of trust and cooperation, partnership even, that are crucial for the relationship to 'work';<sup>1</sup>
  - (e) it acknowledges that imbalances in bargaining power and information that characterise many trading relationships between suppliers and retailers or wholesalers may increase the risk of dealings in 'bad faith';
  - (f) it ameliorates the uncertainty in the common law as to the existence of an implied obligation of good faith in contracts (see further point 16 below); and
  - (g) it is consistent with a desirable policy aim of promoting ethical standards and norms of business conduct, in line with community expectations.<sup>2</sup>
8. The good faith obligation is currently in a free-standing provision that imposes an obligation on retailers and wholesalers additional to those imposed by the other provisions of the FGCC. This is in contrast to the approach under the Groceries Supply Code of Practice in the UK, in which the good faith provision

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<sup>1</sup> See, eg, B Dixon, 'Common law obligations of good faith in Australian Commercial Contracts – A Relational Recipe' (2005) 33 *Australian Business Law Review* 87. The same is said of franchising contracts. See, eg, G Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927.

<sup>2</sup> As reflected also in the prohibitions on unconscionability and unfair contract terms under the *Competition and Consumer Act* 2010.

(Principle of Fair Dealing) is an interpretive provision, that is a provision that is intended to assist in the interpretation of the substantive provisions of the Code.<sup>3</sup>

9. The interpretive role played by the Principle of Fair Dealing in the United Kingdom (UK) is valuable in that it establishes an overarching standard of conduct that imbues the other more specific provisions of the code in that jurisdiction. It means that when there is uncertainty or dispute as to the proper construction of those provisions, one test that may be applied is whether a proposed interpretation would be consistent with the Principle of Fair Dealing.
10. Nevertheless, in our view, the good faith obligation should remain free-standing because:
  - (a) the purposes clause of the FGCC is able to play the same interpretive role as the UK Principle of Fair Dealing;
  - (b) it is inevitable that there will be gaps or loopholes in the other provisions, either currently or in the future and a free-standing good faith obligation may assist in filling those gaps;<sup>4</sup>
  - (c) it means that the obligation is enforceable by the ACCC and prevents suppliers from having to rely on general contract law or other provisions under the *Competition and Consumer Act 2010* (CCA) in connection with an allegation that a retailer has not acted in good faith.
11. Notwithstanding its importance, there was a view expressed in some of the submissions to Treasury's consultation on the draft Code, and echoed in our interviews, that while necessary, the protection afforded by a good faith obligation is not sufficient. The threat of pecuniary penalties (and in a meaningful amount) is required to ensure retailers act in good faith. This view is likely to continue to be held by some and we believe it has merit. We have discussed the issue of penalties for the FGCC breaches with you and will revisit the issue in our written submission in response to the interim report.
12. We are conscious that there are some who doubt the value of the good faith obligation. Such doubts include views that:
  - (a) the obligation would be difficult to enforce in practice;
  - (b) the obligation may create false expectations on the part of suppliers about the nature or extent of a retailer's or wholesaler's obligations which in turn may generate conflict in the relationship;<sup>5</sup>

<sup>3</sup> See *Groceries (Supply Chain Practices) Market Investigation Order 2009* (UK), cl 2:

*Principle of fair dealing: A Retailer must at all times deal with its Suppliers fairly and lawfully. Fair and lawful dealing will be understood as requiring the Retailer to conduct its trading relationships with Suppliers in good faith, without distinction between formal or informal arrangements, without duress and in recognition of the Suppliers' need for certainty as regards the risks and costs of trading, particularly in relation to production, delivery and payment issues.*

<sup>4</sup> This is likely to be even more so should the current review lead to amendments that add further detail or prescriptiveness to the provisions.

<sup>5</sup> We note that a concern relating to the creation of an expectation gap was expressed by Mr Graeme Samuel in his capacity as ACCC Chairman in evidence to the parliamentary Joint Committee in its inquiry into the Franchising Code of Conduct in 2008. See Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Opportunity Not Opportunism: Improving Conduct in Australian Franchising* (2008), quoting Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, 5 November 2008, 96 (Graeme Samuel, Chairman, ACCC).

- (c) the obligation is uncertain in meaning and for that reason is likely either to increase compliance costs or is unlikely to make much difference in practice.

13. We acknowledge these views. However, we believe that the weight of opinion clearly favours the retention of a good faith obligation. Moreover, we note that the importance of such an obligation has been recognised in the consultations relating to and the resultant provisions of all other prescribed Codes.<sup>6</sup>

#### **What does ‘good faith’ in the good faith obligation mean?**

14. There is inherent and unavoidable subjectivity in the concept of good faith. This was reflected in the wide range of interpretations offered by interviewees in our research.<sup>7</sup> Recurring themes in these interpretations were as follows:

- being honest;
- being genuine;
- keeping promises / adhering to commitments;
- listening and keeping the dialogue open;
- making expectations clear;
- taking the other party’s interests into account;
- not making threats;
- being fair;
- different to not acting unconscionably;
- doing the right thing.

15. As is apparent from this list, some see good faith as largely entailing considerations of procedural justice – for example, being willing to listen, clear about expectations and open to negotiation. Others see it as more substantive in character, for example taking account of the interests of the other party in any negotiation or decision affecting those interests and reaching fair outcomes. The list bears out the observation that good faith is a construct ‘which means different things to different people in different moods at different times and in different places’.<sup>8</sup>

<sup>6</sup> See *Competition and Consumer (Industry Codes—Horticulture) Regulations 2017* (Cth), Division 3—Obligation to deal in good faith; *Competition and Consumer (Industry Codes—Oil) Regulations 2017* (Cth), cls (32(8) and 45(1)); *Competition and Consumer (Industry Codes— Franchising) Regulation 2014* (Cth), Division 3—Obligation to act in good faith; *Competition and Consumer (Industry Code—Port Terminal Access (Bulk Wheat)) Regulation 2014* (Cth), cl 6. See also ACCC, *Dairy Inquiry: Final report*, Canberra, April 2008, which proposes a mandatory code for the dairy industry and that the code require that ‘processors and farmers to act in good faith during negotiations, performance of the contract, dispute resolution and the ending of an agreement.’ The utility of a good faith obligation and associated issues of meaning, scope and application were considered in Department of Agriculture and Water Resources 2017, *Australian Government response to the Independent Review of the Horticulture Code of Conduct*, Canberra, February, 2017; Mark Napper and Allan Wein, *Independent Review of the Horticulture Code of Conduct: Final Report*, Department of Agriculture and Water Resources, Canberra, November, 2015; Alan Wein, *Review of the Franchising Code of Conduct: Report to the Hon Gary Gray AO MP, Minister for Small Business, and the Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business*, 30 April 2013.

<sup>7</sup> See C Beaton-Wells and J Paul-Taylor, [Codifying supermarket-supplier relations: A report on Australia’s Food and Grocery Code of Conduct](#), 1 September 2017, Ch 7. VI (C) c) ii: [Good Faith](#).

<sup>8</sup> M Bridge, ‘Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?’ (1984) 9 *Canadian Business Law Journal* 385, 407.

16. The common law both as to the existence of an implied obligation of good faith and as to the meaning of 'good faith' (particularly as it applies in the context of general contract law) is complex and contested. However, insofar as there is an express, implied or incidental common law obligation to act in good faith, the following recurring themes are discernible in the meaning that has been given to it in the jurisprudence:

- acting honestly;
- acting reasonably;
- acting fairly;
- paying due regard to the interests of the other party (which does not equate to not acting in or acting against one's own legitimate interests);
- acting in accordance with the legitimate and reasonable expectations of the parties upon entering the contract;
- not acting in bad faith, which would include not acting arbitrarily, capriciously, unreasonably, opportunistically, recklessly, or with extraneous or ulterior motives.<sup>9</sup>

17. The vagueness and imprecision of the jurisprudence on the meaning of 'good faith' has been criticised by some.<sup>10</sup> Others have argued that while a coherent doctrinal underpinning is lacking, 'the courts have demonstrated that they are able to know it when they see it, or more properly that they know a breach of it when they see it'.<sup>11</sup>

### **Should 'good faith' in the good faith obligation be defined and if so, how?**

18. There are three possible perspectives on this question:

- (1) It is not necessary or not possible and may even be hazardous to attempt a definition of 'good faith' and its meaning should therefore be left for determination as a matter of statutory construction;
- (2) It is possible and helpful to parties, as well as to the ACCC and courts, to provide a definition of 'good faith';
- (3) Whether or not a definition of 'good faith' is provided, it is possible and helpful to provide a non-exhaustive list of matters that may be taken into account in determining whether or not a party has acted (or not acted) in good faith.

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<sup>9</sup> Several of the attributes associated with good faith in the case law were reflected in the 'guiding principles' that Treasury identified in its consultation paper on the draft Code, namely honesty, cooperation, reasonableness and fairness. See Treasury, *Improving commercial relationships in the food and grocery sector*, Consultation Paper, August 2014, 44.

<sup>10</sup> A Terry and C Di Lerna, 'Franchising and the quest for the Holy Grail: Good Faith or Good Intentions' (2009) 33 *Melbourne University Law Review* 542.

<sup>11</sup> Economic and Finance Committee, Parliament of South Australia, *Final Report — Franchises*, Report No 65 (2008), 55.

19. The good faith obligation in the FGCC reflects perspectives (1) and (3). 'Good faith' is defined by reference to 'the meaning of the unwritten law as in force from time to time' (subcl 28(1)), a list of matters that may be taken into account in determining whether a retailer or wholesaler has acted in good faith in dealing with a supplier is provided (subcl 28(3)), and it is clear that the list is non-exhaustive (subcl 28(4)).

20. While the matter is finely balanced, we favour perspective (1) for the following reasons:

- (a) in construing the meaning of 'good faith' in the good faith obligation it can be expected that a court would have regard to the way in which the term has been interpreted at common law;
- (b) however, it is preferable that allowance be made for a court to extend or refine that meaning in the context of the purposes and provisions of the FGCC, and the particular circumstances of the case at hand, whereas sub cl28(1) may be taken to preclude such extension or refinement;
- (c) reference to the unwritten law for the purposes of definition is unlikely to assist businesses in understanding the meaning of the obligation, at least without recourse to legal advice;
- (d) moreover, it is evident from our research that retailers and suppliers already have an understanding of what 'good faith' means or should mean and that understanding is consistent with the various interpretations that exist at common law (see above);
- (e) a list of relevant factors or considerations may provide some guidance in interpretation but such guidance is necessarily incomplete and possibly arbitrary and may risk unduly limiting or distorting interpretations in ways that are not anticipated in advance;
- (f) in relation to the factors in sub cl28(3):

para (a): it is not clear why the absence of duress was singled out for explicit inclusion in the list;

para (b): reference to the recognition for certainty regarding the risks and costs of trading is arguably superfluous as certainty permeates much of the Code's provisions and has emphasis in the statement of the Code's purposes;<sup>12</sup>

para (c): it is difficult to understand why whether the supplier has acted in good faith is relevant to a determining whether a retailer or wholesaler has acted in good faith - a retailer or wholesaler should not be permitted to act in bad faith on account of a view that a supplier has done so.

21. We nevertheless consider that it is both possible and helpful for the ACCC to provide guidelines on how it interprets the meaning of 'good faith' in the good faith obligation. The ACCC currently provides some guidance on its website.<sup>13</sup> That guidance refers to the fact that obligation provides for 'good faith' to have the same meaning as at common law and goes on to summarise aspects of that law and provide two

<sup>12</sup> See FGCC, cl 2(b).

<sup>13</sup> See <https://www.accc.gov.au/business/industry-codes/food-and-grocery-code-of-conduct#good-faith>.

examples of how it might apply in the setting of the Code. Consideration should be given to whether and ways in which those guidelines may be extended, including through the provision of additional examples.

### **What should be the scope of the good faith obligation?**

22. It is important to consider the scope of the good faith obligation, that is to the range of actions, decisions and circumstances that would attract the obligation. In our view, the obligation should be given the widest scope possible.
23. In our view, the obligation should not be restricted to the specific matters governed by the other provisions of the Code.
24. Moreover, the good faith obligation should apply to every aspect and stage of dealing between a retailer or wholesaler and a supplier in relation to a grocery supply agreement, including negotiating the terms of, entering into, varying, renewing, resolving disputes relating to and terminating the agreement.<sup>14</sup>
25. The good faith obligation provides that retailers or wholesalers 'must at all times deal with suppliers... in good faith'. We recommend that cl 28 be amended to clarify that 'at all times deal' is to be interpreted as giving the obligation the scope referred to above.

### **Who should the good faith obligation apply to?**

26. At the time of Treasury's consultation on the draft Code, there was debate as to whether the good faith obligation should be mutual, that is apply to suppliers as well as retailers and wholesalers. Some submitters favoured mutuality. Our interviews with stakeholders did not identify this as a residual concern.
27. The good faith obligation does not and cannot extend to suppliers as the FGCC only provides for retailers and wholesalers to elect to be bound by it.
28. However, we note that a mediator or arbitrator may determine that a supplier is not acting in good faith in a mediation or arbitration and that upon such determination, the retailer or wholesaler would not be required to take part in the mediation or arbitration (cl 38(5)(b)).

### **How should the good faith obligation be amended?**

29. Having regard to the foregoing analysis, we recommend consideration be given to amendment to cl 28 so that it provides as follows:

#### **28 Obligation to deal in good faith**

- (1) The retailer or wholesaler must deal with suppliers in good faith.
- (2) Without limiting subclause (1), the obligation on a retailer or wholesaler to deal with a supplier in good faith:

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<sup>14</sup> We note this is consistent with the guidelines of the ACCC, at <https://www.accc.gov.au/business/industry-codes/food-and-grocery-code-of-conduct#good-faith>.



(a) applies to every aspect and stage of dealing between a retailer or wholesaler and a supplier in relation to a grocery supply agreement, including negotiating the terms of, entering into, varying, renewing, resolving disputes relating to and terminating the agreement; and

(b) is not limited to matters arising under or in connection with this code.

(3) The retailer or wholesaler must not enter into a grocery supply agreement that contains a provision that limits or excludes the obligation to act in good faith, and if it does, the provision has no effect.

30. In relation to proposed sub cl28(1):

(a) The reference to dealing 'lawfully' has been removed as it is superfluous. It is not necessary to impose an obligation to comply with the law.

(b) The reference to 'within the meaning of the unwritten law as in force from time to time' has been removed for the reasons set out above.

31. Proposed sub cl (2) addresses the scope of the good faith obligation, as explained above.

32. In relation to proposed sub cl28(3):

(a) It is important to retain this subclause to prevent a retailer or wholesale from attempting to contract out of the good faith obligation.

(b) The subclause is limited to contracting out of the obligation in a grocery supply agreement. Consideration may be given to including a further subclause to prevent contracting out by way of another document or agreement or in any other way.

33. The current subcl 28(3) and subcl 28(4) have been omitted for the reasons set out above. Should it be determined that some definitional guidance is necessary or would be helpful, we would recommend that current subcl 28(3) be amended to become subcl 28(4) as follows:

(4) Without limiting the meaning of 'good faith' in subclause (1), in determining whether a retailer or wholesaler has acted in good faith in dealing with a supplier, the meaning of 'good faith' in the unwritten law, as in force from time to time, may be taken into account.

We would be pleased to answer any questions or discuss any aspect of this submission if it would assist the Review.