

Is the CISG an Appropriate Option for Australian and Chinese Businesses? A Good Faith Perspective

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This article investigates the suitability of the CISG as an applicable law for disputes between Australian and Chinese businesses. It first examines the vague role of good faith in Art. 7(1) CISG, revealing that the divergence between the narrow and broad interpretations of good faith may result in uncertainties. Furthermore, the difference between Australian and Chinese attitudes towards the CISG in general, and good faith in particular, renders the good faith issue even more problematic. A close examination and comparison of judicial and arbitral practices relating to good faith in Australia and China further complicates the certainty and predictability of the application of good faith in contractual disputes relating to the CISG. This article, therefore, suggests that the CISG should be chosen with great caution by Chinese and Australian parties as the governing law for their international sales contracts.

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1 Introduction

The United Nations Convention on Contracts for the International Sale of Goods (CISG)¹ is regarded as the most successful text prepared by the United Nations Commission on International Trade Law (UNCITRAL)² and represents a landmark,³ or a milestone,⁴ in the course of the unification of international trade law. No other convention relating to contract law has had an impact as profound as the CISG.⁵

Although the CISG appears to be a great success, the position of China and Australia in dealing with CISG are radically different: while both are signatories, it is observed that China is pro-CISG⁶ whereas Australia has an opt-out culture of the CISG.⁷ Such a difference would expose the parties to significant risks such as contradictory legal opinions, differences in expectations, and even surprisingly unfamiliar legal environment in dispute resolution. Consequently, this article discusses the appropriateness of the CISG as an option for Australian and Chinese businesses in international transactions in the context of the increasingly influential trade relationship between these two countries.⁸ It concentrates on the suitability of the CISG from a perspective of good faith which is one of the most

¹ *United Nations Convention on Contracts for the International Sale of Goods*, opened for signature 11 April 1980, 1489 UNTS 3 (entered into force 1 January 1988) (CISG).

² Steven D Walt, 'The Modest Role of Good Faith in Uniform Sales Law' (2015) 33 *Boston University International Law Journal* 37, at p. 41.

³ Michael Joachim Bonell, 'The UNIDROIT Principles of International Commercial Contracts and CISG – Alternatives or Complementary Instruments?' (1996) 1 *Uniform Law Review* 26, at p. 26.

⁴ Gyula Eörsi, 'A Propos the 1980 Vienna Convention on Contracts for the International Sale of Goods' (1983) 31 *The American Journal of Comparative Law* 333, at p. 334.

⁵ Reinhard Zimmermann, 'European Contract Law: General Report' (2007) 15 *Europäische Zeitschrift für Wirtschaftsrecht* 455, at p. 457.

⁶ Lisa Spagnolo, *CISG Exclusion and Legal Efficiency* (2014, Kluwer Law International) at pp. 151-2.

⁷ According to Spagnolo, there is only limited number of cases discussing CISG in Australia, reflecting a culture of opting out the CISG in Australia. See Lisa Spagnolo, 'The Last Outpost: Automatic CISG Opt Outs, Misapplications and the Costs of Ignoring the Vienna Sales Convention for Australian Lawyers' (2009) 10(1) *Melbourne Journal of International Law* 141, at p.159.

⁸ Australia and China became significant trade partners in the last a few decades. According to the report provided by the Department of Foreign Affairs and Trade, in the 2017 calendar year, China is Australia's biggest trading partner in the sense of both exports (AUD \$115,996 million) and imports (AUD67, 397 million). Dr Anne Holmes also reported that Australia is China's sixth largest trading partner, fifth biggest supplier of imports and tenth biggest customer for exports. See Department of Foreign Affairs and Trade, '*Australia's Trade in Goods and Services (a)(b) by Top 15 Partners*', available at: <<http://dfat.gov.au/trade/resources/trade-statistics/trade-in-goods-and-services/Documents/australias-goods-services-by-top-15-partners-2017.pdf>>; Dr Anne Holmes, 'Australia's economic relationships with China', available at: <https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook44p/China>; This mutually-beneficial relationship has great significance to both countries, and the rest of the world, because China is the world's second largest economy and Australia the thirteenth. See International Monetary Fund, <<https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx>>.

salient and distinctive aspects marking the differences between civil law and common law jurisdictions⁹ to which China and Australia belong, respectively.

The following Part 2 outlines the role and different interpretations of good faith in the CISG and reveals the uncertainties good faith may bring. Part 3 presents how good faith in the CISG is applied in Australia and China. Significant differences in the application render further discussions of good faith in domestic laws necessary. Part 4 discusses the status of good faith in Australian contract law. Farther, Part 5 analyses the role of good faith in Chinese contract law, examines the meaning and functions of good faith, and investigates how good faith is applied by the Chinese courts. Part 6 concludes that due to different attitudes towards good faith in Australian and Chinese contract laws, and the unclear role of good faith in the CISG, it is highly likely that the application of good faith will cause uncertainty and unpredictability in Australia-China trade activities. While the CISG is expected to be used more frequently in this context,¹⁰ its provisions, especially the good faith principle, should be selected with great caution.

2 Good Faith under the CISG

When drafting CISG, there were hot debates on some issues due to divergences and inconsistencies in domestic laws of contracting states. In order to achieve the

⁹ Many civil law countries, such as Germany and China, recognise a general principle of good faith. For example, in Germany the principle of good faith is so general that the whole system of German private law might be taken as an embodiment of it and could be administered based on it only. Peter Schlechtriem, *Good Faith in German Law and in International Uniform Laws* (Centro di Studi e Ricerche di Diritto Comparato e Straniero, 1997) at p.1; On the Contrary, in many common law countries, there is not a general principle of good faith, such as the UK and Australia. For instance, in the UK there has been neither an overriding positive duty of good faith nor a general doctrine of good faith. See Raphael Powell, 'Good Faith in Contracts' (1956) 9 *Current Legal Problems* 16, at p. 32 and Ewan McKendrick, *Contract Law: Texts, Cases and Materials* (Oxford University Press, 7th ed, 2016) at p.486. The difference between civil law and common law on good faith is best illustrated by Bingham L.J.'s statement in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*, that:

'In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as 'playing fair', or 'coming clean' or 'putting one's cards face upwards on the table'. It is in essence a principle of fair and open dealing... English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.'

See, *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1988] 1 All. E.R. 348, at p.352 per Bingham L.J.

¹⁰ See for example, Spagnolo, (fn 7), at p.213.

goal of a broad and general acceptance of the CISG, the drafters needed to compromise on certain issues.¹¹ Good faith is undoubtedly one of those.¹²

In fact, good faith is mentioned solely in Art. 7(1) of the CISG, which reads as follows:

‘In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observation of good faith in international trade.’¹³

The ambiguity of the expression ‘the observation of the good faith in international trade’ renders the role of good faith uncertain and as shown below, has caused heated debates on its interpretation.

2.1 A narrow or broad interpretation of Art. 7(1) CISG

Due to the vague reference to good faith in Art. 7(1), different views have been expressed on the interpretation of good faith within the CISG. The first contention is that good faith should be interpreted narrowly. Good faith should be applied only in the interpretation of the CISG itself, and should not be regarded and used as a general principle nor should it be viewed as imposing a duty on parties to act in good faith.¹⁴ Furthermore, where good faith is used to interpret the CISG, its meaning and the application should be limited by the international nature of trade activities. Accordingly, the interpretation of good faith should restrain from making any recourse to domestic law taking into account the desire to achieve an autonomous and international interpretation of the CISG.¹⁵

¹¹ Stefan Kröll, ‘Selected Problems Concerning the CISG’s Scope of Application’ (2005) 25 *Journal of Law and Commerce* 39, at p. 39.

¹² In the course of drafting this Art. 7(1), there were lengthy and heated discussions regarding whether to incorporate good faith into the CISG and how to do it. See John O Honnold, *Documentary History of the Uniform Law for International Sales* (1989, Kluwer Law and Taxation Publishers) at pp. 298-9, 369-370. The current wording of Art. 7(1), although strange, leaves the door ajar for good faith to be further elaborated and developed in an international uniform sales law. Gyula Eörsi, ‘A Propos the 1980 Vienna Convention on Contracts for the International Sale of Goods’ (1983) 31 *The American Journal of Comparative Law* 333, at p. 349.

¹³ CISG Art. 7(1).

¹⁴ See John O Honnold, *Uniform Law for International Sales* (3rd ed, 1999, Kluwer Law International) at p. 100; E Allen Farnsworth, ‘Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Conventions, and National Laws’ (1995) 3 *Tulane Journal of International and Comparative Law* 47, at pp. 55-7; Peter Winship, ‘Commentary on Professor Kastley’s Rhetorical Analysis’ (1988) 8 *Northwestern Journal of International Law and Business* 623, at pp. 631-3.

¹⁵ See Alexander S Komarov, ‘Internationality, Uniformity and Observance of Good Faith as Criteria in Interpretation of CISG: Some Remarks on Article 7(1)’ (2005) 25 *Journal of Law and Commerce* 75, at p. 78; John Honnold, ‘The Sales Convention in Action – Uniform International Words: Uniform Application?’ (2008) 8 *Journal of Law and Commerce* 207, at p. 208; Bruno Zeller, ‘Good Faith – The Scarlet Pimpernel of the CISG’ (2001) 6 *International Trade and Business Law Review* 227, at pp. 227-8.

The second contention is that there should be a broad interpretation of good faith under the CISG. Good faith is not limited to the interpretation of the CISG itself and should be regarded as a general principle of the CISG.¹⁶ Following this understanding, good faith could be applied not only in the interpretation and application of the CISG itself, but also to the legal relations (rights and obligations) between the parties to a contract governed by the CISG.¹⁷

In addition, since the CISG is an international treaty, the Vienna Convention on the Law of Treaties (Vienna Convention) should also be considered in order to interpret good faith in the CISG. Article 31(1) of the Vienna Convention stipulates that ‘a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose’.¹⁸ Therefore, the CISG, as a treaty, ought to be interpreted in good faith taking into account the ordinary meaning, object, and purpose of its terms both textually and contextually. Also, according to Art. 31(3) of the Vienna Convention, ‘any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation’ shall be taken into account in the interpretation of a treaty.¹⁹ Hence, a necessary step would be to refer to the case law applying Art. 7(1) CISG in practice. In the present instance, however, such reference is of little assistance. The application of Art. 7(1) in case law is amorphous as some cases follow the narrow approach whereas other cases take the broad approach.²⁰ Complicating the matter further is the several means of applying good faith under the broad approach, meaning that good faith can be applied as dicta; as an alternative basis for a result achieved on other grounds; as an additional consideration which supports the achieved result; and as an independent ground for a result.²¹ It seems that a consensus between the narrow and broad interpretations of good faith is out of reach, which brings uncertainties in the application of Art. 7(1).

¹⁶ See Bonell’s comments on Art. 7 in C M Bianca and M J Bonell (eds), *Commentary on the International Sales Law: the 1980 Vienna Sales Convention* (1987, Giuffrè, Milan) at p. 85; Amy H Kastely, ‘Unification and Community: A Rhetorical Analysis of the United Nations Sales Convention’ (1988) 8 *Northwestern Journal of International Law and Business* 574, at pp. 597-9; John O Honnold, *Documentary History of the Uniform Law for International Sales* (fn 12) at p. 408.

¹⁷ See Schlechtriem’s comments on Art. 7 in Peter Schlechtriem and Ingeborg Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* (2nd (English) ed, 2005, Oxford University Press, Oxford) at p. 95; Bruno Zeller, ‘Good Faith – Is it a Contractual Obligation?’ (2003) 15 *Bond Law Review: Festschrift for David Allan and Mary Hiscock* 214, at pp. 220-6.

¹⁸ Vienna Convention on the Law of Treaties, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980) Art. 31(1).

¹⁹ *ibid* Art. 31(3).

²⁰ Clayton P Gillette and Steven D Walt, *The UN Convention on Contracts for the International Sale of Goods: Theory and Practice* (2nd ed, 2016, Cambridge University Press, Cambridge) at pp. 137-8.

²¹ *ibid* at pp. 138-144.

2.2 Uncertainties in applying Art. 7(1) CISG

The narrow and broad interpretations of good faith generate at least two uncertainties in the application of Art. 7(1). First of all, it is uncertain whether good faith will be applied only in the interpretation of the CISG itself or whether it will also guide individual contracts and the contractual relationship governed by the CISG.

Secondly, another uncertainty arises out of the application of good faith to contractual relationship between the parties. On the one hand, if good faith is considered as a general principle, it could be a risk that good faith may become boundless, and eventually it may, in meaning everything, mean nothing.²² On the other hand, a broad interpretation may in the course of time result in the emergence and recognition of a general duty of good faith according to which parties should act.²³ For example, in the absence of an expressed term on good faith in the contract, deciding whether the parties intended to permit the application of good faith to their contractual relationship is a matter of contractual interpretation. Under the broad interpretation approach, it might be inferred that the parties implicitly agree to be bound by good faith considering the peculiar status and vague role of good faith under the CISG, and it would be very difficult, if not impossible, to argue that good faith should be excluded or avoided.

In light of the uncertainties regarding the application of good faith and the lack of global homogeneous case law suggesting a uniform interpretation of good faith in the context of international trade, it appears undeniable that a national court's discretion must be engaged as to the understanding and application of good faith in international sales contracts. This article reviews the practices in Australia and China to examine whether any common ground exists regarding the application of good faith in general contract law situations and discusses whether such practices would give rise to a preferable approach of applying good faith in line with the application of CISG in the context of Australia-China trade.

3 Applying Good Faith in China and Australia in the Context of CISG: the Possible Impact of Domestic Law

The uncertainties which good faith may bring should ring an alarm to any business in international trade. As discussed earlier, many scholars urge that the interpretation and application of good faith in the CISG should be defined by its international nature, and a recourse to domestic definitions or understanding of good faith should be avoided. It is, however, difficult to discern a 'purely international' good faith in practice. No uniform understanding of international good faith is observed at either a theoretical or practical level. The application and

²² Michael Bridge, 'The CISG and the UNIDROIT Principles of International Commercial Contracts' (2014) 19 *Uniform Law Review* 623, at p. 637.

²³ Fritz Enderlein and Dietrich Maskow, *International Sales Law, United Nations Convention on Contracts for the International Sale of Goods, Convention on the Limitation Period in the International Sale of Goods* (1992, Oceana Publications, New York) at pp. 54-5.

interpretation of the CISG still relies on the practice of arbitration tribunals and courts worldwide, which evidently are impacted by different legal cultures.

From this perspective, it would be hard to deny that the application of CISG, including its good faith provision, is not be affected by domestic practices. A brief review of cases applying CISG in both China and Australia evinces this view.

China and Australia both contribute to CISG case law. However, according to the case database on the CISG provided by UNCITRAL,²⁴ there is not a single Australian case in which good faith Art. 7(1) is applied. Neither do other Australian CISG cases²⁵ assist in the clarification of good faith under Art. 7(1) as they tend to primarily refer to domestic laws rendering misapplication or ignorance of the CISG.²⁶ So far, good faith in Art. 7(1) has only been referred to in *obiter* by Priestley JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*,²⁷ and by Finn J in *South Sydney District Rugby League Football Club Ltd v News Ltd and Others*.²⁸

Conversely, there are four reported Chinese cases on good faith in Art. 7(1) in CLOUT. It is notable that in some of these cases, the application of good faith is supported by not only the CISG but also domestic law. For example, in CLOUT Case No. 1702,²⁹ a Korean buyer could not obtain a refund after the goods failed the quality inspection and were returned to a Chinese seller. The Chinese court held that, the applicable law should be the CISG, and for issues not covered by the CISG, the Chinese law should apply. Thus, the court held that, in the absence of an explicit agreement between the parties, it was reasonable to expect the seller to refund the buyer following the return of goods on the basis of Art. 7(1) of the CISG, Art. 4 of the Chinese General Principles of Civil Law, and Art. 61 of the Chinese Contract Law. Similarly, in CLOUT Case No. 1118,³⁰ the tribunal referred to the good faith principle provided by Chinese Contract Law in defining the performance of the contract, but also held that ‘the behaviour of the seller had been inconsistent with the principles of honesty and credibility and the requirement that the contract was to be honoured in good faith (Art. 7(1) CISG)’ and therefore breached the contract.

A Chinese tribunal also uses good faith to decide that a typographical error, which amounts to documentary non-conformity, would not amount to a fundamental

²⁴ Case Law on UNCITRAL Texts (CLOUT), see <http://www.uncitral.org/uncitral/en/case_law.html>

²⁵ A database on Australian cases on the CISG is <<http://www.business.vu.edu.au/cisg/cases.asp>>

²⁶ Bruno Zeller, ‘The Duty to Mitigate: A Comparative Analysis between the English Common Law and the CISG’ (2018) 92(3) *Australian Law Journal* 205, at pp. 206-7. See also Spagnolo, (fn 7), at pp. 167-207.

²⁷ (1992) 26 NSWLR 234, at p. 264. See also s. 4.

²⁸ (2000) 177 ALR 611, at p. 696. See also s. 4.

²⁹ People’s Republic of China: Rizhao City Intermediate People’s Court, Shandong Province, (2013) Ri Min San Chu Zi No. 4 (12 December 2013).

³⁰ People’s Republic of China: China International Economic & Trade Arbitration Commission (CIETAC), Shenzhen Commission (now South China Branch) (7 December 2005).

breach in CLOUT Case No. 808.³¹ In CLOUT Case No. 1105,³² according to the contract, the buyer would make payment through a letter of credit, and the seller would send the bill of lading to the buyer only on the condition that the buyer accepted the consequent risk of taking delivery of goods. Although not clearly defined by the contract, the tribunal held that the buyer had an obligation to make prompt payment for the goods upon receiving the bill of lading and taking delivery of the goods in accordance with Arts. 7(1) and 53 of the CISG.

The lack of Australian cases involving Art. 7(1) and Australian courts' homeward trend attitude in applying the CISG contrast obviously and sharply with the versatile use of Art. 7(1) by the Chinese tribunals and courts, as well as its interaction with the understanding of good faith under Chinese domestic law. This stark contrast has prompted our review on how Australian contract law and Chinese contract law deal in turn with good faith.³³

4 Good Faith in Australian Contract Law

There are an overwhelming number of cases, books, articles and other material in relation to good faith in Australian contract law. It is pointed out that '[t]he material available on this issue, whether judicial, academic or otherwise, is so voluminous that one is at pains to know where to dive in'.³⁴ Therefore, the task of unveiling good faith is quite challenging and an attempt to do so exhaustively is virtually impossible. Hence, this section gives only an overview of the core issues relating to good faith.

In general, the status of good faith in Australian contract law is controversial. The controversy lies in the recognition of the good faith principle in state and federal courts and the reluctance of the High Court of Australia to follow suit.

4.1 The status of good faith in state and federal courts

In case law, good faith has been recognised and established by both state and federal courts as an implied term in contract performance.³⁵

In New South Wales, *Renard Constructions (ME) Pty Ltd v Minister for Public Works*³⁶ was the first case in which good faith was addressed. This case concerned a termination clause in a building contract which conferred the principal powers to take over part or all of the work or termination the contract on the condition that, upon the occurrence of a default, the contractor failed to show cause to the

³¹ People's Republic of China: China International Economic & Trade Arbitration Commission (CIETAC) (4 June 1999).

³² People's Republic of China: China International Economic & Trade Arbitration Commission (CIETAC), Shenzhen Commission (now South China Branch), CISG/2000/12 (6 November 2000).

³³ See ss. 4 and 5.

³⁴ Marilyn Warren, 'Good Faith: Where are We at?' (2010) 34 *Melbourne University Law Review* 344, at p. 345.

³⁵ Jeannie Paterson, Andrew Robertson and Arlen Duke, *Principles of Contract Law* (5th ed, 2016, Thomson Reuters Australia) at p. 350.

³⁶ (1992) 26 NSWLR 234.

principal's satisfaction why the principal should not exercise the powers. When discussing an implied term of reasonableness requiring the principal to exercise the powers reasonably, Priestley JA stated:

‘The kind of reasonableness I have been discussing seems to me to have much in common with the notions of good faith which are regarded in many civil law systems of Europe and in all States in the United States as necessarily implied in many kinds of contract. Although this implication has not yet been accepted to the same extent in Australia as part of judge-made Australian contract law, there are many indications that the time may be fast approaching when the idea, long recognized as implicit in many of the orthodox techniques of solving contractual disputes, will gain explicit recognition in the same way as it has in Europe and in the United States.’³⁷

In this case Priestley JA referred to extensive materials, including art 7(1) of the CISG which was not directly relevant.³⁸

Following *Renard Constructions*, subsequent cases have implied a good faith term in various types of commercial contract besides building contracts, including franchise contracts, commercial leases and loan contracts.³⁹ Despite the fact that *Renard Constructions* was a New South Wales case, the implied term of good faith approach it had taken was adopted by other state courts.⁴⁰

An implied term of good faith has also, to a certain degree, won favour in the Federal Court of Australia. In *Hughes Aircraft Systems International v Airservices Australia*,⁴¹ the Federal Court addressed the implication of a duty of good faith and fair dealing. Hughes Aircraft Systems International (Hughes) was the unsuccessful tenderer in a two-party bid for the award by the Civil Aviation Authority (the CAA) of the Australian Advanced Air Traffic System Acquisition contract (TAAATS II). The successful tender was Thompson Radar Australia Corporation (“Thompson”). The core of Hughes’ claim was that the CAA, by contract, representation or promise, obliged itself to conduct the tender process fairly, but failed to satisfy this obligation in many respects. Finn J discussed the

³⁷ *ibid* at pp. 263-4.

³⁸ *ibid* at p. 264.

³⁹ Paterson, Robertson and Duke, ‘Principles of Contract Law’ (fn 35) at p 353. For franchise contracts, see e.g. *Far Horizons Pty Ltd v McDonalds Australia Ltd* [2000] VSC 310, *Burger King Corp v Hungry Jack’s Pty Ltd* (2001) 69 NSWLR 558; for commercial leases see e.g. *Alcatel Australia v Scarcella* (1998) 44 NSWLR 349; for loan contracts see e.g. *Commonwealth Bank of Australia v Renstel Nominees Pty Ltd* [2001] VSC 167.

⁴⁰ See *Far Horizons Pty Ltd v McDonalds Australia Ltd* [2000] VSC 310; *Eso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228; *Central Exchange Ltd v Anaconda Nickel Ltd* [2002] WASCA 94; *Tone Tasmania Pty Ltd v Garrott* [2008] TASSC 86; *De Pasquale v The Australian Chess Federation Incorporated* [2000] ACTSC 94.

⁴¹ (1997) 146 ALR 1.

good faith issue under a section titled as ‘(a) Good faith and fair dealing’.⁴² His Honour said that:

‘The applicant’s submission is that the proposed term is a manifestation of a general implied duty of good faith and fair dealing. I have, in consequence, been invited to embrace the conclusion of Priestley JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*, above, at 268 that:

*people generally, including judges and other lawyers, from all strands of the community, have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all contracts of a duty upon the parties of good faith and fair dealing in its performance. In my view this is in these days the expected standard, and anything less is contrary to prevailing community expectations.*⁴³

After referring to some other Australian authority on the implied duty of good faith and fair dealing, his Honour continued:

‘Having said this, it is also appropriate to indicate that my own view inclines to that of Priestley JA. Of that inclination I would say only this. Fair dealing is a major (if not openly articulated) organizing idea in Australian law. It is unnecessary to enlarge upon that here. More germane to the present question, the implied duty is, as is well known, an accepted idea in the contract law of the United States and, probably of Canada (...) Its status in civil law is well recognised...It has been propounded as a fundamental principle to be honoured in international commercial contracts (...) Its more open recognition in our own contract law is now warranted (...)

I should add that (...) I consider a virtue of the implied duty to be that it expresses in a generalisation of universal application, the standard of conduct to which all contracting parties are to be expected to adhere throughout the lives of their contracts. It may well be that, on analysis, that standard would be found to advance little the standard that presently may be exacted from contracting parties by other means (...) But setting the appropriate standard of fair dealing is, in my view, another matter altogether from acceptance of the duty itself.’⁴⁴

Apart from this case, the Federal Court of Australia has also recognised the implied duty of good faith in other cases.⁴⁵ In *South Sydney District Rugby League*

⁴² *ibid* at p. 36.

⁴³ *ibid*.

⁴⁴ *ibid* at p. 37.

⁴⁵ See e.g. *South Sydney District Rugby League Football Club v News Ltd* (2000) 177 ALR 611; *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288.

*Football Club Ltd v News Ltd and Others*⁴⁶, an implied duty of good faith and fair dealing was recognised in particular types of commercial contracts. This case concerned an objection by the applicant rugby league club to the fact and manner of its exclusion from the 14-team rugby league competition administered by one of the respondents, the National Rugby League (“NRL”), for 2000. One of the key issues was whether the NRL partners acted fairly and in good faith in evaluation of which club would be offered participation in the 2000 season and beyond. When addressing whether an implied term requiring NRL partners to act fairly and in good faith existed, Finn J noted that:

‘Australian law has not yet committed itself unqualifiedly to the proposition that every contract imposes on each party a duty of good faith and fair dealing in contract performance and enforcement (...) Such a duty has been accepted as an implied legal incident of particular classes of contract (...) and particularly contracts of a commercial character (...) notwithstanding the supposed uncertainty in defining the concept of “good faith and fair dealing” (...) I would note in passing that the supposed uncertainty with “good faith” terminology has not deterred every State and Territory legislature in this country from enacting into domestic law the provisions of Article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods (...)’⁴⁷

This finding was consistent with results of state cases. Also, it showed that in the Court’s view the uncertainty that good faith in Art. 7(1) of the CISG may bring about was not insurmountable. Although Art. 7(1) was not directly applied, this judgment did push the understanding of Art. 7(1) in Australia further than merely mentioning it in *Renard Constructions*.

In practice, law firms have started to advise their clients to be aware of and pay heed to the potential duty of good faith in the performance of contractual obligations.⁴⁸ The implied duty of good faith is also supported by academics; they argue that good faith is either an implied duty in all kinds of contracts,⁴⁹ or at least in relational commercial contracts.⁵⁰

⁴⁶ (2000) 177 ALR 611

⁴⁷ *ibid* at pp. 695-6

⁴⁸ Warren, ‘Good Faith’ (fn 34) at p. 347.

⁴⁹ See Rich Ladbury, ‘Implied Duty of Good Faith: A Comment’ (2002) *Australian Mining and Petroleum Law Association (AMPLA) Yearbook* 22, at p. 46; Bruno Zeller and Camilla Baasch Andersen, ‘Good Faith – The Gordian Knot of International Commerce’ (2016) 28 *Pace International Law Review* 1, at p. 10.

⁵⁰ Howard Munro, ‘The “Good Faith” Controversy in Australian Commercial Law: A Survey of the Spectrum of Academic Legal Opinion’ (2009) 28 *The University of Queensland Law Journal* 167, at pp. 175-6. Bill Dixon, ‘Common Law Obligations of Good Faith in Australian Commercial Contracts – A Relational Recipe’ (2005) 33 *Australian Business Law Review* 87, at pp. 95-8.

It is, however, noteworthy that there are also cases⁵¹ and academic views⁵² against the existence of good faith as an implied duty, refuting the necessity of such a duty and expressing concerns on the uncertainty and unpredictability it may bring.

4.2 The status of good faith in the High Court of Australia

In *Royal Botanic Gardens and Domain Trust v South Sydney City Council*,⁵³ the High Court of Australia, recognised the significance of the doctrine of good faith, but did not determine the existence of such a doctrine, nor its content and scope if it did exist. Kirby J, in dissent, denied the existence of an implied duty of good faith and fair dealing by stating:

‘However, in Australia, such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include.’⁵⁴

In the joint judgement delivered by Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ, their Honours showed an unwillingness to address the issue by stating:

‘The second matter concerns the debate in various Australian authorities concerning the existence and content of an implied obligation or duty of good faith and fair dealing in contractual performance and the exercise of contractual rights and powers (...) The result is that, whilst the issues respecting the existence and scope of a “good faith” doctrine are important, this is an inappropriate occasion to consider them.’⁵⁵

Callinan J was of the same opinion, deciding that:

‘[I]t is unnecessary to answer the question (...) whether both in performing obligations and exercising rights under a contract, all parties owe to one another a duty of good faith; and, the extent to which, if such were to be the law, a duty of good faith might deny a party an opportunistic or commercial exercise of an otherwise lawful commercial right.’⁵⁶

⁵¹ See *GSA Group v Siebe PLC* (1993) 30 NSWLR 573; *Hunter Valley Skydiving Centre Pty Ltd v Central Coast Aero Club Ltd* [2008] NSWSC 539.

⁵² See Elisabeth Peden, ‘Good Faith in the Performance of Contract Law’ (2004) 42 *Law Society Journal* 64, at p. 64; Elisabeth Peden, “‘Implicit Good Faith’ – or Do We Still Need an Implied Term of Good Faith?” (2009) 25 *Journal of Contract Law* 50, at p. 51.

⁵³ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289.

⁵⁴ *ibid* at p. 312.

⁵⁵ *ibid* at p. 301.

⁵⁶ *ibid* at p. 327.

Kirby J agreed with the joint reasons and the reasons of Callinan J mentioned above in respect to the unnecessary exploration of the good faith issue.⁵⁷

In the more recent case of *Commonwealth Bank of Australia v Barker*,⁵⁸ the High Court of Australia did not show a tendency to adopt either a general principle of good faith or an implied duty of good faith.

It is worth noting that Peden proposes that good faith is applied during the construction of a contract.⁵⁹ Peden argues that *Carr v J A Berriman Pty Ltd*⁶⁰ shows implicit good faith which means that the good faith construction was recognised and adopted by the High Court of Australia.⁶¹ However, there has been no official response to this view from the High Court of Australia.

In *Lange v Australian Broadcasting Corporation*, the High Court of Australia has ruled that:

‘There is but one common law in Australia which is declared by this Court as the final court of appeal. In contrast to the position in the United States, the common law as it exists throughout the Australian States and Territories is not fragmented into different systems of jurisprudence, possessing different content and subject to different authoritative interpretations.’⁶²

The view that there is only one common law in Australia was affirmed by the High Court of Australia in *Lipohar v The Queen*⁶³ by citing McHugh J’s statement in *Kable v Director of Public Prosecutions (NSW)*:

‘[T]here is a common law of Australia as opposed to a common law of individual States is clear.’⁶⁴

The High Court of Australia also added that:

‘To assert that there is more than one common law in Australia or that there is a common law of individual States is to ignore the central place which precedent has in both understanding the common law and explaining its basis.’⁶⁵

Therefore, it is difficult to determinatively argue that good faith plays a significant role in Australian contract law until the High Court of Australia makes a decision addressing the good faith issue in a future case. Unfortunately, given the High Court of Australia’s reluctance to address the issue in the aforementioned cases, it

⁵⁷ *ibid* at p. 312.

⁵⁸ (2014) 253 CLR 169.

⁵⁹ Elisabeth Peden, *Good faith in the performance of contracts* (2003, LexisNexis Butterworths, Sydney) at p. 2.

⁶⁰ (1953) 89 CLR 327.

⁶¹ Peden, ‘Implicit Good Faith’ (fn 52) at pp. 60-1.

⁶² (1997) 189 CLR 520, at p. 563.

⁶³ (1999) 200 CLR 485.

⁶⁴ (1996) 189 CLR 51, at p. 112.

⁶⁵ (1999) 200 CLR 485, at p. 505.

does not seem likely that it will take an opportunity to clarify the status of good faith in the foreseeable future.⁶⁶

5 Good Faith in Chinese Contract Law

Good faith is regarded as one of the fundamental and general principles in Chinese Contract Law⁶⁷ (CCL). Chinese academics and courts have generally accepted and embraced the principle of good faith as an indispensable principle of CCL.⁶⁸ It is, therefore, of great importance to understand the meaning, functions and scope of the principle of good faith before considering the application of it in practice.

5.1 The principle of good faith under the Chinese Contract Law: definition, function and scope of application

The principle of good faith applies in all contexts of civil law in China as a general principle.⁶⁹ Specifically, it is stipulated in CCL Art. 6, ‘the parties shall abide by the good faith principle in exercising their rights and performing their obligations.’ It is so fundamental that it is widely recognised as the ‘imperial principle’ of Chinese Contract Law.⁷⁰

Although the CCL does not provide a legal definition of the principle of good faith, many scholars agree with the proposition that the good faith principle is a combination of legal and moral requirements. They argue that good faith has many manifestations, including that the parties must act with honesty, trustworthiness and good-will; respect the truth, keep promises and not engage in fraud; exercise their rights and obligations in good-will and not evade the law and contracts; balance conflicting interests, and co-operate to achieve reasonable expectations of the parties.⁷¹ It is argued that ambiguity in the meaning of good faith gives rise to the flexibility of its application.⁷² There are, however, concerns over the potential abuse of the broad judicial discretion that the good faith principle confers on the

⁶⁶ There are several issues that the High Court needs to address in order to clarify the role of good faith, such as the relationship between good faith and equitable doctrines, the relationship between good faith and a fiduciary duty, the relationship between good faith and unconscionability. J W Carter and Andrew Stewart, ‘Interpretation, Good Faith and the “True Meaning” of Contracts: The Royal Botanic Decision’ (2002) 18 *Journal of Contract Law* 182, at pp. 193-5.

⁶⁷ Contract Law of the People’s Republic of China, 1999.

⁶⁸ Chunlin Leonhard, ‘A legal Chameleon: An Examination of the Doctrine of Good Faith in Chinese and American Contract Law’ (2010) 25 *Connecticut Journal of International Law* 305, at p. 309.

⁶⁹ General Provisions of the Civil Law of the People’s Republic of China, 2017, Art. 7; also General Principles of Civil Law of the People’s Republic of China, 1986, Art. 4.

⁷⁰ Bing Ling, *Contract Law in China* (2002, Sweet & Maxwell Asia, Hong Kong) at p. 50.

⁷¹ Liang Huixing, ‘The Principle of Good Faith and Gap Filling’ (1994) 91(2) *Chinese Journal of Law* 22, at p. 23; Cui Jianyuan, *Analysis of New Contract Law Theory and Cases* (1999, Jilin University Press) at pp. 26-8; Wang Liming, *Studies on Contract Law* (Vol. 1, 2002, China Renmin University Press) at pp. 163-4. Bing Ling, *Contract Law in China* (fn 70) at pp. 52-4.

⁷² Liang Huixing, ‘The Principle of Good Faith’ (fn 71) at pp. 23-6.

judges and over the unpredictable consequences that the application of this discretion may result in.⁷³

Chinese academics further define the function of the good faith principle from various perspectives. Wang summarises five functions of the principle of good faith: (1) filling in the gaps in laws and contracts; (2) establishing rules for conduct; (3) balancing the interests both between the parties, and between the parties and the society; (4) interpreting law and contracts; and (5) reducing transaction costs and enhancing efficiency.⁷⁴ Liang lists three functions, including (1) guiding the parties to perform their rights and obligations; (2) interpreting, evaluating and supplementing legal activities and (3) interpreting and supplementing the law.⁷⁵ Other academics have also given similar explanations of the functions of the principle of good faith, including gap-filling, providing judicial discretion, and balancing the interests between different parties.⁷⁶

In addition to its application as a general principle of contract law as stipulated in CCL Art. 6, good faith is also regarded as the basis of the doctrine of *culpa in contrahendo* contained in CCL Art. 42. CCL Art. 60 imposes a good faith obligation at the performance stage. CCL Art. 92 requires the parties to act in good faith at the termination of the contract. CCL Art. 125 also requires that the interpretation of any discrepancies in the contract should be done by taking into consideration the principle of good faith. It is also argued that although the doctrine of change of circumstances as a manifestation of the principle of good faith is not directly recognized by the CCL, it is adopted by the Supreme People's Court (hereinafter SPC).⁷⁷

The SPC further endorsed the good faith principle in specific contract law scenarios in its judicial interpretations. For example, it requires the application of the good faith principle in adjusting liquidated damages agreed by the parties in the contract,⁷⁸ and in deciding the 'reasonable period' for inspection.⁷⁹

It is, therefore, reasonable to infer that the principle of good faith is an umbrella term and an overriding principle applicable at every stage of the contract, covering pre-contractual negotiations, formation, performance, termination, post-

⁷³ For a more detailed summary of the critics, see Chunlin Leonhard, 'A legal Chameleon' (fn 68) at pp. 306-9.

⁷⁴ Wang Liming, *Studies on Contract Law* (fn 71) at pp. 169-176.

⁷⁵ Liang Huixing, 'The Principle of Good Faith' (fn 71) at p. 25.

⁷⁶ Zheng Qiang, 'The Doctrine of Good Faith in Contract Laws: a Comparative Perspective' (2000) 1 *Journal of Comparative Law* 38, at p. 40.

⁷⁷ Xu Guodong, *Studies on the Principle of Good Faith* (2002, China Renmin University Press), at pp. 123-4; Wang Liming, *Studies on Contract Law* (fn 71) at p. 169.

⁷⁸ The Supreme People's Court's Interpretation II on Several Issues Concerning the Application of the Contract Law of the People's Republic of China, SPC Judicial Interpretation 2009 No 5, Art. 29.

⁷⁹ The Supreme People's Court's Interpretation on the Application of Law in Dealing with Disputes Arising from Sale Contracts, SPC Judicial Interpretation 2012 No 8, Art. 17.

contractual duties and contractual interpretation. The view is supported by scholars including Jiang,⁸⁰ Wang and Xu.⁸¹

5.2 Application of the good faith principle in China's judicial practice: a study of the SPC cases

Based on the fundamental position of the good faith principle in China's contract law, this section examines a series of SPC decisions applying this principle. Although China is a civil law country and does not have the doctrine of precedent, the cases published by the SPC are usually taken into consideration by the lower courts in dealing with similar situations. This section also reviews other cases decided by lower courts but published by the SPC as Guiding Cases, in which the good faith principle is applied.⁸² All these cases are published by the SPC via one of the following platforms or databases: China Judgments Online⁸³, the SPC's website⁸⁴, or the China Law Info website⁸⁵. Most of these cases are decided in the last five years (2013-2017), representing recent trends in practice.

According to the different roles the good faith principle may play in contractual disputes, the cases are divided into the following categories: (1) application in contractual negotiations; (2) guiding the performance of the contract; (3) application in the assignment of contractual rights and obligations; (4) application in the breach of contract, including the adjustment of liquidated damages; (5) application in the termination of contract; (6) application in the context of the non-existence of a contract; (7) application as a tool of contractual interpretation; (8) application as a general principle.

5.2.1 Application in contractual negotiations

According to the SPC, there might be implied duties arising from the good faith principle even at the pre-contractual stage. In *Hubei Jinhua v Wuhan Haoyu*,⁸⁶ the SPC stated that the parties should act in good faith in negotiations prior to the reaching of the contract. In this case, Haoyu was contracted as the agent to sell all the real estate properties in a project developed by Jinhua. The SPC held that, due to the nature of this proposed legal relationship between the parties, all the sales activities undertaken by Haoyu would rely on Jinhua's duty to disclose the accurate details of the properties, which arose from the application of the good

⁸⁰ Jiang Ping, *A Detailed Explanation of Contract Law* (1999, China University of Political Science and Law Press) at pp. 6-8.

⁸¹ Wang Liming and Xu Chuanxi, 'Fundamental Principles of China's Contract Law' (1999) 13 *Columbia Journal of Asian Law* 1, at pp. 17-22; Wang Liming, *Studies on Contract Law* (fn 71) at pp. 176-8.

⁸² Notice of the Supreme People's Court on Issuing the Provisions on Case Guidance, SPC Notice 2010 No. 51. Its Art. 7 stipulates that the lower courts should refer to the guiding cases when dealing cases involving similar situations.

⁸³ <<https://wenshu.court.gov.cn/>>

⁸⁴ The SPC's website, at <<http://www.court.gov.cn/>>; See particularly the China Guiding Cases, at <<http://www.court.gov.cn/shenpan-gengduo-77.html>>

⁸⁵ <<http://www.pkulaw.cn/>>.

⁸⁶ *Hubei Jinhua Industry Co Ltd v Wuhan Haoyu Real Estate Consulting Co Ltd* – Retrieval of the Commercial Estate Sale Agency Dispute, (SPC, China), Civil Retrieval 2013 No. 143.

faith principle. The significant discrepancies between the facts disclosed by Jinhua prior to the contract and the reality of the unique situation of the properties were not reflected in the contractual language, and such non-disclosure was only discovered in post-contractual correspondence. The SPC held that Jinhua should be responsible for Haoyu's failure to sell the properties as agreed.

5.2.2 Guiding the performance of the contract

The good faith principle may also guide the performance of the contract by the parties. In *Lou Xibiao v Yili Xinlei Construction*,⁸⁷ the SPC stated that the parties should perform their contractual obligations in accordance with good faith. Lou's refusal to perform its obligation, therefore, was not only a breach of the contract but also a violation of the good faith principle. The SPC eventually ruled that the parties should continue performance of the original contract.

In performing the contract, the parties have obligations arising from the good faith principle, such as giving proper notice, assisting the other party, or keeping matters confidential, which might be implied from the nature and purpose of the contract and the usage.⁸⁸ In *Pan v Si County Rural Commercial Bank*,⁸⁹ Pan was persuaded to deposit a significant amount of money into a particular bank branch to receive 16% instant interest payment from someone else, who was later found to be involved in fraudulent financial activities. Had Pan acted in good faith and performed its obligation to report this unusual interest payment to the bank or the police under Art. 60, it would not have suffered the loss of its deposit in the later financial fraud. Pan's failure to act in good faith should be taken into consideration when calculating damages.

In *Zhende v Hengsheng*,⁹⁰ Zhende, the distributor, was under a contractual obligation to sell a certain amount of goods provided by Hengsheng, the producer. The parties disputed on Zhende's performance, as Hengsheng alleged that the targeted amount should be calculated in accordance with different categories of goods separately, instead of a total amount. The SPC held that the instruction as to the calculation of the goods according to different categories was only communicated by Hengsheng to Zhende when the former decided to terminate the contract, which was inconsistent with Hengsheng's prior representation of accepting Zhende's sale record in previous years. Thus, Hengsheng breached the good faith obligation it had under Art. 60.

When the performance fails for some reason, the parties should also act in good faith. In *Hebei Zhuolong Property Development v Jiangsu Construction &*

⁸⁷ *Lou Xibiao v Yili Xinlei Residential Property Construction Co Ltd* – Retrial of the Sale Contract Dispute, (SPC, China), Civil Retrial Application 2014 No. 1057.

⁸⁸ CCL Art. 60.

⁸⁹ *Pan Shouxiang v Anhui Si County Rural Commercial Bank Co.* – Appeal on the Deposit Contract Dispute, (SPC, China), SPC Civil Appeal 2017 No. 311.

⁹⁰ *Guangdong Zhende Pharmaceutical Co Ltd v Hunan Hengsheng Pharmaceutical Co* – Appeal on the Other Contract Dispute, (SPC, China), SPC Appeal 2016 No. 116.

Engineering Group,⁹¹ the SPC held that when the parties could not proceed with performance, the parties should consult each other in good faith in reaching a new agreement. Failing to do so, the parties should make decisions quickly and responsibly to mitigate the losses of both.

5.2.3 Application in the assignment of contractual rights and obligations to a third party

In a series of cases brought by Cai Fuying,⁹² the assignment of the parties' rights and obligations towards a third party should also follow the good faith principle. If the parties attempted to assign its debts to a third party in order to avoid its debt payment of the original contract, such assignment might be held invalid. Cai sought to enforce its judgement debt against a company named Fanrong, only to find Fanrong had attempted to assign its property rights to a shell company and to third parties. These third parties then disputed the enforcement of Cai's judgement debt, claiming that the property had been transferred. The SPC held that the transaction between Fanrong, its shell company, and third parties was fraudulent and for the purpose of avoiding the judgement debt, therefore they did not act in good faith and their claims should not be allowed.

5.2.4 Application in the breach of contract

Good faith can be applied in deciding whether there is a breach of contract. In *Ziyun Government v Shunxing Property*,⁹³ the parties agreed that, should the government plan to use part of the land developed by Shunxing, the amount of the subsidy paid by the government should be calculated on the basis of the cost of the actual expenses of the development project. Although the final price Shunxing claimed was much higher than expected, the agreed subsidy represented the parties' mutual consent in signing the contract and should be followed in good faith. The government's refusal of this subsidy payment was a breach of contract, and also a breach of the good faith principle and strict compliance.

Under CCL Art. 114 the agreement between parties regarding liquidated damages should be respected in good faith.⁹⁴ Depending on the specific circumstances,

⁹¹ *Hebei Zhuolong Property Development Co v Jiangsu Construction & Engineering Group Co* – Retrial on the Construction and Engineering Contract Dispute, (SPC, China), Civil Retrial 2015 No. 708.

⁹² *Wang Suijing v Cai Fuying* – Debt Dispute – Claim raised by the Third Party on the Enforcement of Judgment, (SPC, China), Civil First Branch Final 2014 No.166; *Guo Ziyun v Cai Fuying* – Debt Dispute – Claim raised by the Third Party on the Enforcement of Judgment, (SPC, China), Civil First Branch Final 2014 No. 200; *Lin Shuni v Cai Fuying* – Debt Dispute – Claim raised by the Third Party on the Enforcement of Judgment, (SPC, China), Civil First Branch Final 2014 No. 201.

⁹³ *Ziyun Miao and Buyi Autonomous County People's Government v Guizhou Ziyun Property Co Ltd* – Appeal on the Contract Dispute, (SPC, China), SPC Civil Final 2016 No. 440.

⁹⁴ *Hunan Province No. 3 Construction Engineering Co Ltd v Xiangxi Autonomous City Xinhui Real Estate Development Co Ltd* – Retrial on the Construction Engineering Project Contract Dispute, (SPC, China), SPC Civil Retrial 2016 No. 1472; *Weifang Shengda Real*

however, the court has the discretion to adjust the liquidated damages by taking into consideration various factors on the basis of the good faith principle as well as the fairness principle.⁹⁵ In *Huaihua Road & Bridge v Tanheng Highway*,⁹⁶ the SPC held that the primary purpose of the damages, which is to remedy rather than to punish the other party, had already been met by other damages rendered by the lower court; the party suffering losses might also contribute to its losses. Therefore, the agreed liquidated damages were considered too high and too harsh and were required to be adjusted.

5.2.5 Application in the termination of contract

When there is a breach of contract or potential breach, parties should also act in good faith to solve the dispute before considering the termination of the contract. Both *Tangshan Xindaihe Real Property v Tangshan Kangtai Construction & Engineering*⁹⁷ and *Yinchuan Xinhua Department Store v Ningxia Great World*⁹⁸ provide that the parties should consult each other in good faith to solve the dispute before claiming for damages or terminating the contract.

If the legal or agreed conditions for termination are not met, attempts to terminate the contract would not be upheld by the court because of the lack of good faith. In *Zhongyi Huahai v Fugu Hongsheng Colliery et al.*,⁹⁹ Zhongyi Huahai terminated the contract because the purpose of the joint investment in the collieries could not be fulfilled. The SPC found that the jointly invested project was ready to be registered and that it was Zhongyi Huahai that was reluctant to proceed with the registration due to a downturn in the coal market. The SPC therefore held that the Colliery companies were not in breach of contract and that Zhongyi Huahai's termination did not meet any legal condition, violated the good faith principle, would cause unjustified difficulties to the other parties. Similarly, in *Chengdu Hexinzhiyuan v Nanbu Jinli*,¹⁰⁰ the parties specifically restricted the parties' right to terminate by agreement. The SPC held that, due to the nature of the legal relationship between the parties, their shared interests and mutual trust, the parties should act in good faith and did not have a discretionary right to terminate this contract.

Estate Development Co Ltd v Wang Gen Zhao – Retrieval on the Residential Property Pre-Sale Contract Dispute, (SPC, China), SPC Civil Retrieval 2016 No. 3103.

⁹⁵ See the SPC's Judicial Interpretation II on the Application of the CCL (fn 78) Art. 29.

⁹⁶ Hunan Province Huaihua Road & Bridge Construction Co v Hunan Tanheng Highway Development Co Ltd – Appeal on the Debt Contract Dispute, (SPC, China), SPC Civil Final 2017 No. 504.

⁹⁷ *Tangshan Xindaihe Real Estate Development Co Ltd v Tangshan Kangtai Construction & Engineering Co Ltd* – Retrieval of the Contract of the Transfer of the Land Use Right, (SPC, China), Civil Retrieval 2015 No. 35.

⁹⁸ *Yinchuan Xinhua Department Store Group Co v Ningxia Great World Industrial Co Ltd* – Appeal on the Lease Contract Dispute, (SPC, China), SPC Civil Final 2016 No. 743.

⁹⁹ *Zhongyi Huahai Import & Export Co Ltd v Fugu County Miaogoumen Village Hongsheng Colliery et al.* – Appeal on the Contract Dispute, Supreme People's Court, People's Republic of China, Civil Second Branch Final 2014 No. 129, July 2014.

¹⁰⁰ *Chengdu Hexinzhiyuan Real Estate Consulting Co Ltd v Sichuan Province Nanbu County Jinli Property Development Co Ltd* – Appeal on the Agency Contract Dispute, (SPC, China), Civil First Branch Final 2015 No. 226.

5.2.6 Application in the context of unjust enrichment

The good faith principle also applies in the situation where the contract is declared invalid. In *Jiangsu Suzhong Construction v Xinjiang Shuiqingmuhua Property Investment*,¹⁰¹ the parties had concluded a main contract. In performing this contract, the parties later reached further agreement on payment and liabilities. The main contract was later declared invalid, but the SPC held that, following the good faith principle, the subsequent agreement on payment and liabilities should be regarded as the parties' agreement on liabilities in the situation of restitution to avoid the possible unjust enrichment of one party in the absence of a valid main contract.

Similarly, in *Lin Jinfang et al. v Hainan Tianjing Farm et al.*,¹⁰² one party agreed that they would invest in several farms for profits from their joint project in the future. The cooperation never eventuated, and the contract was terminated. The SPC held that, as the investors would never get their expected benefits under the contract, allowing the farms to only return the amount without paying any further interest would make the farms unjustly enriched, and breached the good faith principle. Thus, the farms were held to pay back not only the fund but also the interest incurred.

5.2.7 Application as a tool of contractual interpretation

CCL Art. 125 guides the application of the good faith principle in the interpretation of contract clauses. In *Qinhuangdao Qiuran Property v Geshan Construction Group*,¹⁰³ the contract provided that 'The Party issuing the contract should pay within 10 days 85% of the completed part when the Builder completes the 10th floor of the building. The Party issuing the contract also agree to pay 85% of the completed part on the Lunar Calendar 10 December of 2018, or the construction were delayed or stopped due to reasons not caused by the Builder.' The parties disputed the meaning of this clause. Qiuran (the party issuing the contract) read this clause as they would only pay 85% either when Geshan completed the 10th floor, or, if not completed, on Lunar Calendar 10 December on the condition that such delay was not caused by Geshan. Thus, it refused to pay when the 10th floor was not completed, and the delay was not caused by external reasons on the agreed date. The court held that the appropriate reading should be that the payment of the completed part should be done on (1) the 10th day after the completion of the 10th floor, or (2) Lunar Calendar 10th December 2018; or (3) when any delay occurred, and such delay was not caused by Geshan. These three circumstances should be independent from each other. Following Art. 125, the SPC held this interpretation

¹⁰¹ *Jiangsu Province Suzhong Construction Group Co v Xinjiang Shuiqingmuhua Property Investment Co Ltd* – Appeal on the Construction and Engineering Contract Dispute, (SPC, China), SPC Civil Final 2016 No. 733.

¹⁰² *Li Jinfang, et al. v Hainan Tianjing Farm Co Ltd et al.* – Appeal on the Joint Venture and Cooperation on Development of Property Contract Dispute, (SPC, China), SPC Civil Final 2016 No. 517.

¹⁰³ *Qinhuangdao Qiuran Property Development Co Ltd v Geshan Construction Group Co Ltd* – Retrial on the Construction and Engineering Contract Dispute, (SPC, China), Civil Retrial 2013 No. 2023.

‘is consistent with the good faith principle and the concept of fairness’. On the contrary, Qiuran’s reading of this clause ‘exceeds the expectation of ordinary person and imposes additional duty of care on Geshan’; nor did they specifically notify their unreasonable understanding of this clause to Geshan.

In *Huaihua Fuda Property Development v Huaihua Kaledi Hotel*,¹⁰⁴ the lease agreement between the parties stated that Fuda, the property owner, should not introduce any other tenant competing with Kaledi in the same type of business during the lease. The parties disputed the interpretation of the word ‘introduce’. The SPC held that, considering the particular nature of the contract,¹⁰⁵ and Kaledi’s reasonable expectation, a good faith interpretation of the word ‘introduce’ should be that Fuda should not actively seek any competitor of Kaledi, and should impose a restriction on any potential lease in the future to exclude Kaledi’s competitor. Kaledi had agreed to this clause and should bear the cost of implementing it, and its failure to prevent Kaledi’s competitor in later renting activities justified Kaledi’s termination of the lease agreement.

In *Lu’an Huayu Property Development v Zhang Yu*,¹⁰⁶ Huayu borrowed RMB 50 million from Zhang. In securing the debt, the parties signed a property purchase and buyback agreement which provided that ‘when Huayu intends to buy back the property purchased by Zhang within one month, it should pay 52.5 million; in two months, 55.5 million; in three months, 57.5 million; ...when Zhang received the payment, the parties should then terminate the property purchase agreement and de-register the intended purchase.’ Huayu then refused to repurchase the property from Zhang and claimed that the clause should be interpreted as a discretionary right as to whether it would do so. The SPC held that the real intention of the parties was to have a debt agreement and use the purchase agreement to secure the debt. Thus, in the absence of a clear representation to indicate that the right to buyback is discretionary, to interpret the buyback clause as purely one party’s right would be against fundamental civil law principles such as autonomy, fairness, equal value and equally compensated, and good faith. Such an interpretation should not be accepted.

5.2.8 Application as a general principle

In addition to the application of the good faith principle in specific contract-related scenarios, the SPC may also consider good faith as a general and guiding principle in determining general issues of contract law. For example, in *Xinjiang Eagle Property Development v Nantong Fourth Construction Group*,¹⁰⁷ Eagle refused to pay Nantong and Nantong stopped performance. Eagle then sued Nantong for

¹⁰⁴ *Huaihua Fuda Property Development Co Ltd v Huaihua Kaledi Hotel* – Retrial on the Lease Contract Dispute, (SPC, China), Civil Retrial 2015 No. 399.

¹⁰⁵ In this case, when the lease contract was signed, the 24-level building was only leased out for 2-3 levels, and Kaledi’s lease agreement on 9 levels of this building was a significant one for both parties.

¹⁰⁶ *Lu’an City Huayu Property Development Co Ltd v Zhang Yu* – Appeal on the Debt Transfer Dispute, (SPC, China), Civil First Branch Final 2013 No. 144.

¹⁰⁷ *Xinjiang Eagle Property Co Ltd v Nantong Fourth Construction Group Co Ltd* – Appeal on the Construction Contract Dispute, (SPC, China), SPC Civil Final 2017 No. 133.

breach of contract and claimed for damages and continuing performance. The SPC held that such claims were not based on facts, had no grounding in law, and violated good faith and social public order indicated in Arts. 7 and 8 of the General Provisions of the Civil Law.

In *Qingdao Wanhe Thermal Power v Qingdao Houhai Thermal Power et al.*,¹⁰⁸ the parties reached a settlement agreement during the appeal of their original dispute. The SPC held that, although the settlement agreement was not recognised and given force as a judgment in the original legal proceeding, it represented the mutual consent between the parties. The parties should respect this agreement in good faith. When it was not performed, the complying party should be given the right to bring a new suit on the basis of this agreement.

In *Zhongning Rural Credit Cooperation Association v Xing Xuehua*,¹⁰⁹ Zhongning Association transferred its debt claim against its debtor to Xing. Zhongning Association did not disclose to Xing that such debt claim was pending under a litigation proceeding, and when Xing delayed paying the full amount for the transaction, Zhongning Association notified the court that it would enforce against its debtor after its restructure process. The court, following such notice, terminated the enforcement proceeding, making Xing's claim against the debtor impossible. The SPC held that the Zhongning Association's act of terminating its enforcement proceeding against its debtor was not in good faith, significantly increased Xing's risk of fulfilling his purpose of the debt-transfer transaction, and exceeded its legal defences against Xing's delay in payment. Thus, Zhongning Association breached its contract with Xing.

5.3 Concluding China's approach

After reviewing China's legislation and academic discussion, and examining the recent Chinese case law on the application of good faith, it is suggested that good faith plays a fundamental role in shaping and regulating the contractual relationship in China's legal practice. It is observed to be applied in different contractual law scenarios and is referred to by the Chinese court in solving disputes covering every stage of the contract. In addition, the Chinese court treats good faith as a versatile tool to tackle many different legal issues, or to support its legal reasoning on these issues, which might be otherwise solved by existing contract law rules. The court even uses good faith to alter contractual provisions or to create obligations not expressly mentioned in the contract. This creates great uncertainties and potential inconsistencies in contract-related legal practice in China.

¹⁰⁸ *Qingdao Wanhe Thermal Power Co Ltd v Qingdao Houhai Thermal Power Co Ltd et al.*- Appeal on the Contract Dispute, (SPC, China), Civil Second Branch 2015 No. 364.

¹⁰⁹ *Zhongning County Rural Credit Cooperation Association v Xing Xuehua* – Retrial on the Auction Contract Dispute, (SPC, China), Civil Retrial 2015 No. 1077.

6 Conclusion

After seeing the role of good faith in the CISG, Australian contract law and Chinese contract law, one may envisage three main uncertainties that may cause concerns and that are worth further investigation.

The first uncertainty is the role of good faith under the CISG. The vague and unclear role of good faith as reflected in the drafting history and various academic views on its role and application will result in unpredictability in its practical application and subsequent ramifications. There is a risk that parties who choose the CISG as the governing law to their contracts may not be able to lay down their rights and obligations, or allocate risks with certainty as they intend to because of the various possible ways of understanding and approaches to applying the good faith concept. How can the parties know whether they are under a duty to act in good faith; whether good faith, if considered as a general principle on which the CISG is based on, permeates their contract or only applies to interpretation of the contract; whether they can exclude good faith? How can they have confidence in choosing the CISG? How can they expect to achieve contractual goals and obtain the interests that they intend to obtain from their contract? Few reasonable businessmen, even those with less extensive experience in international trade, would take such a risk. This is a risk that both Australian and Chinese businesses might wish to avoid.

The second uncertainty lies in the different understandings of and approaches to good faith by Australian and Chinese courts. Despite the uncertainty inherent in the role of good faith under the CISG, parties might eliminate the first uncertainty by reaching an agreement or conclusion that good faith exists, and nevertheless decide to choose the CISG as the governing law to their contract. However, they may put the contract in danger due to the different attitudes to good faith in Australia and China.

Good faith may be interpreted differently by Australian and Chinese Courts. Australian courts may interpret and apply good faith in various ways. Good faith may be considered and applied as an implied duty or may not be recognised or applied by state or federal courts. Also, despite decisions rendered by lower courts recognising good faith, the High Court of Australia has not officially recognised the existence of good faith in Australian contract law, either as a general principle or as a concrete duty. If a case relevant to good faith could eventually be heard by the High Court of Australia, it would be very difficult to predict its attitude and view.

Unlike Australian courts, the SPC applies good faith as a general principle which permeates every stage of a contract. In the application of good faith, it takes on many manifestations as reflected in the case law. It is extremely difficult to promote a uniform interpretation of good faith. Also, there is the inevitable risk that good faith can be misapplied and even abused due to the fact that it is almost undefinable and confers too much discretionary power on courts.

Although the approaches taken by Australian and Chinese courts discussed above are on the basis of their domestic cases, the domestic decisions reflect, to a certain

degree, the differences in how Australian and Chinese courts deal with the good faith issue and how they conduct their legal reasoning. The existence of these differences will not eliminate the concerns that the domestic courts can deal with the good faith issue in international sales contracts in a fundamentally different way. These differences may also cause concerns as to whether courts will apply Art. 7(1) of the CISG in a uniform way and avoid domestic interpretations in their applications of it. All this may lead to uncertainty in not only the contracts but also the contractual relationship between the parties and eventually result in unfair or unjust consequences of certain contractual disputes.

Taking into account this sharp difference between Australian law and Chinese law in this regard, when parties choose the CISG as the governing law, Art. 7(1) of the CISG may be interpreted by Australian and Chinese courts very differently and may, therefore, bring risks to them.

The third uncertainty is caused by the relationship between the CISG and UNIDROIT Principles of International Commercial Contracts (PICC).¹¹⁰ Academics have expressed a view that the PICC can be used as a means of interpreting and supplementing the CISG.¹¹¹ Some judges and arbitrators have accepted this view and applied the PICC to interpret and supplement the CISG.¹¹² PICC Art. 1.7 imposes a positive duty on the parties to act in accordance with good faith in international trade.¹¹³ According to the official comment to Art. 1.7, good faith may be regarded as one of the fundamental ideas underlying the PICC in light of the fact that many provisions contained in different chapters of the PICC constitute a direct or indirect application of good faith in one way or another.¹¹⁴ If the PICC can be used to interpret and supplement the CISG, good faith might be brought into the CISG via this backdoor regardless of its vague status under the CISG. This again brings uncertainty to the application of the CISG. Also, it is unclear whether Australian and Chinese domestic courts will recognise the role of the PICC as an interpretation or gap-filling tool. And if they do, how will they apply Art. 1.7?

One small mistake in contract drafting in international trade might cause incurable, unpredictable and unrecoverable loss. This is the first thing that any experienced international business would intend to avoid and the last thing that they would want to get involved in. Based on the three uncertainties discussed above, choosing the CISG, at least from the good faith perspective, may be a mistake. Unless parties can find a feasible and satisfactory way to deal with the good faith issue, it might not be wise for them to opt in the CISG jurisdiction.

¹¹⁰ This article refers to PICC 2016 edition.

¹¹¹ See Michael Joachim Bonell, 'The Law Governing International Commercial Contracts and the Actual Role of the UNIDROIT Principles' (2018) 23 *Uniform Law Review* 15, at pp. 32-3.

¹¹² *ibid* at pp. 33-4.

¹¹³ PICC Art. 1.7.

¹¹⁴ Comment 1 to Art. 1.7.