



## GOOD FAITH IN ENGLISH CONTRACT LAW

### Introduction

Many foreign jurisdictions of both civil and common law traditions have long recognised an obligation to act in good faith when making and performing contracts. Historically, this was not an approach recognised by the English courts. Rather, English law was said to have "*committed itself to no... overriding principle [of good faith] but has developed piecemeal solutions in response to demonstrated problems of unfairness*".<sup>1</sup>

The absence of a general, overriding duty to act in good faith does not however, mean that this is not an issue with which English courts have had to grapple. EU legislation frequently imposes such a duty on contracting parties,<sup>2</sup> whilst the common law also recognises a duty to act in good faith in certain specific types of contract eg contracts of employment or insurance. What is more, the Courts will enforce express contractual terms that parties are to act in good faith and it would now seem in light of the decision in *Yam Seng Pte Ltd (a company registered in Singapore) v International Trade Corporation Ltd*<sup>3</sup> ('Yam Seng') that they are also willing to imply such terms into commercial contracts in certain circumstances.

This article focuses on the last two of those eventualities, namely express and implied contractual obligations to act in good faith, and it does so with reference to a number of decisions of the last two years.

#### *What is good faith?*

Perhaps the first question to ask is exactly what is 'good faith'? Unfortunately, the answer is that it depends. In *Berkeley Community Villages Ltd and another v Pullen and others*,<sup>4</sup> Morgan J was required to construe a clause in the following terms: 'In all matters relating to this agreement the parties will act with the utmost good faith towards one another and will act reasonably and prudently at all times'. This he concluded provided for an:

*"obligation to observe reasonable commercial standards of fair dealing in accordance with [the parties'] actions which related to the Agreement and also requiring faithfulness to the agreed common purpose and consistency with the justified expectations of the First Claimant".*<sup>5</sup>

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<sup>1</sup> *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433 at 439.

<sup>2</sup> Eg. Unfair Terms in Consumer Contracts Regulations 1999, reg 5(5) which give effect to a European directive; Financial Services Distance Marketing Directive 2002/65/EU; see Chitty on Contract Law (31st ed), Vol 1 at para 1-043.

<sup>3</sup> [2013] EWHC 111 (QB).

<sup>4</sup> [2007] EWHC 1330 (Ch).

<sup>5</sup> *ibid.* at [97].



In *CPC Group Ltd v Qatari Diar Real Estate Investment Co*<sup>6</sup> Vos J (as he then was) held that an obligation to act in good faith precluded a party from cynically resorting to the black letter of the law.<sup>7</sup> He also found that it required: observing reasonable commercial standards of fair dealing, being faithful to the agreed common purpose, and acting consistently with the justified expectations of the parties.<sup>8</sup>

Interestingly, Vos J also held that it did not require a party to subordinate their self interest in the same way that a fiduciary would.<sup>9</sup> A similar point was made in *Gold Group Properties Ltd v BDW Trading Ltd (formerly known as Barratt Homes Ltd)*<sup>10</sup> where it was held that whilst good faith required the parties to act in a way that will allow them both to enjoy the anticipated benefits of the contract, it did not require either party to give up a freely negotiated advantage embedded in the contract.<sup>11</sup>

More recently in *Yam Seng Leggatt J* 'emphasised' that "... *the content of the duty to perform a contract in good faith is dependent on context*". However, in the Judge's view there were at least two 'aspects' to good faith which he drew out from some of the aforementioned authorities. The first was "*honesty*"<sup>12</sup> and the second, was "*fidelity to the parties*" bargain'.<sup>13</sup>

Leggatt J also held that the test is "*objective in the sense that it depends not on either party's perception of whether particular conduct is improper but on whether in the particular context the conduct would be regarded as commercially unacceptable by reasonable and honest people*".<sup>14</sup> In doing so, he relied on the decision in *Royal Brunei Airlines v Tan*.<sup>15</sup>

The importance of context has been emphasised in a number of the more recent authorities. The Court of Appeal in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)*<sup>16</sup> (*the Medirest Case*) held that the content of the duty of good faith is heavily conditioned by context.<sup>17</sup> In *Greenclose Ltd v National Westminster Bank plc*<sup>18</sup> Andrews J DBE described 'context' as being 'vital' whilst in *TSG Building Services plc v South Anglia Housing Ltd* Akenhead J pithily described the case as encouraging both "*a textual but also a contextual interpretation of commercial contracts*".<sup>19</sup>

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<sup>6</sup> [2010] EWHC 1535 (Ch).

<sup>7</sup> At [67].

<sup>8</sup> At [246].

<sup>9</sup> At [67].

<sup>10</sup> [2010] EWHC 1632 (TCC) [91].

<sup>11</sup> *ibid.* at [91].

<sup>12</sup> [2013] EWHC 111 (QB) at [135].

<sup>13</sup> *ibid.* at [139].

<sup>14</sup> *ibid.* at [144].

<sup>15</sup> [1995] 2 AC 378 .

<sup>16</sup> [2013] EWCA Civ 200.

<sup>17</sup> At [109] per Jackson LJ and see also [150] per Beatson LJ.

<sup>18</sup> [2014] EWHC 1156 (Ch) [150].

<sup>19</sup> [2013] EWHC 1151 (TCC) at [36].



Whilst the context will determine the content of the duty, the authorities suggest that the following specific duties may be found within a general duty of good faith. In *Yam Seng*, a duty not to knowingly provide false information was held to exist.<sup>20</sup> In *Bristol Groundschool Ltd v Intelligent Data Capture Ltd and others*<sup>21</sup> Richard Spearman QC (sitting as a deputy High Court judge) applied *Yam Seng* and held that: 'good faith extends beyond, but at the very least includes, the requirement of honesty'.<sup>22</sup>

In the recent decision of *D&G Cars v Essex Police Authority*,<sup>23</sup> Dove J stated that he used the word 'integrity' in much the same way as Leggatt J had used the phrase good faith in *Yam Seng*.<sup>24</sup> Dove J held that the phrase encompassed "*requirements of fair dealing and transparency*". It was also held that integrity (and therefore presumably good faith) precluded acts which might be difficult to characterise as dishonest but which "*would compromise the mutual trust and confidence between the parties... without necessarily amounting to the telling of lies, stealing or other definitive examples of dishonest behaviour*".<sup>25</sup>

In summary, the content of the duty owed will depend upon the contractual context. It is likely to extend beyond a bare requirement of honesty and will also incorporate a requirement of fidelity to the contract. The test for breach of any requirement of honesty is objective and a material question will be whether the conduct of the parties was 'commercially unacceptable'.<sup>26</sup>

### **Express terms**

Where parties expressly provide for a duty to act in good faith, the Courts will give effect to the parties' intentions. However, the mere fact that a good faith clause (or similar) exists in the contract does not mean that the Courts will construe the clause as imposing upon the parties a general duty of good faith. This restrictive approach is demonstrated by the Court of Appeal's decision in the *Medirest* case.

In *Medirest*, clause 3.5 of the contract provided that:

'The Trust and the Contractor will co-operate with each other in good faith and will take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable the Trust or, as the case may be, any Beneficiary to derive the full benefit of the Contract.'

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<sup>20</sup>[2013] EWHC 111 (QB) at [156].

<sup>21</sup>[2014] EWHC 2145 (Ch).

<sup>22</sup>At [196 iv].

<sup>23</sup>[2015] EWHC 226 (QB).

<sup>25</sup>At [175].

<sup>26</sup>*Medirest* at [150]; *Bristol Groundschool* at [196].



The Court of Appeal refused to accept that the clause provided for a general duty to act in good faith, holding instead that the obligation was confined to the specific circumstances contemplated by the clause:

*"The obligation to co-operate in good faith is not a general one which qualifies or reinforces all of the obligations on the parties in all situations where they interact. The obligation to co-operate in good faith is specifically focused upon the two purposes stated in the second half of that sentence.*

*Those purposes are:*

- i) the efficient transmission of information and instructions;*
- ii) enabling the Trust or any beneficiary to derive the full benefit of the contract."*<sup>27</sup>

In *TSG Building Services plc v South Anglia Housing Ltd*, there was a clause which required the parties to work together in the 'spirit of trust, fairness and mutual co-operation' and which also required the parties to act 'reasonably'. Again, those obligations were interpreted restrictively and were held not to extend to a party exercising an unqualified contractual right to terminate the contract.<sup>28</sup>

In *Fujitsu Services Ltd v IBM United Kingdom Ltd*,<sup>29</sup> a clause in a sub-contract stated that IBM would discharge its obligations in accordance with 'good industry practice' which was separately defined as IBM acting as 'a skilled and experienced provider of [IT services] ... seeking in good faith to comply with its contractual obligations'. Once more, this clause was construed restrictively and was held not to provide for 'an express duty of good faith on the part of IBM in the performance of its duties'.<sup>30</sup> Carr J DBE gave three reasons for this. First (unlike in *Berkley Community Villages v Pullen*), there was no direct provision for the obligation.<sup>31</sup> Second, a duty to act in good faith would be otiose where there was a warranty to perform in any event.<sup>32</sup> Third, the language contained in the clause was found not to support a general duty of good faith.<sup>33</sup>

In summary, whilst the Courts are willing to give effect to a contractual term which imposes a general duty of good faith on the parties, their approach to construing such clauses has been restrictive. The exercise of unqualified contractual rights are unlikely to be subject to such

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<sup>27</sup> [2013] EWCA Civ 200 at [106] – [107].

<sup>28</sup> [2013] EWHC 1151 (TCC) [42].

<sup>29</sup> [2014] EWHC 752 (TCC).

<sup>30</sup> *ibid.* at [150].

<sup>31</sup> *ibid.* at [151].

<sup>32</sup> *ibid.* at [153].

<sup>33</sup> *ibid.* at [154].



obligations and good faith clauses drafted in the contemplation of specific purposes are unlikely to be construed as imposing a general duty on parties.

### *Implied duty*

Perhaps the most significant development in this area has been the 2013 decision of Leggatt J in *Yam Seng* in which he held that a duty of good faith could be implied into a commercial contract.

In *Yam Seng*, the Claimant (YS) entered into a distribution agreement with International Trade Corp Ltd (ITC) under which it was entitled to distribute Manchester United branded products through certain outlets. The relationship did not turn out to be a happy one and YS terminated the agreement after fifteen months and subsequently commenced proceedings against ITC alleging, amongst other things, breaches of an implied duty to deal with one and other in good faith.

Leggatt J noted the weight of academic commentary on the question of whether English law should recognise a duty of good faith but also observed the absence of any decision of an English Court in which the issue had been addressed in any depth.<sup>34</sup> He concluded that he doubted whether English law had reached the stage, where it was ready to recognise a requirement of good faith as a duty implied by law into all commercial contracts.

However, that observation was qualified by the following:

*"Nevertheless, there seems to me to be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties."*<sup>35</sup>

*Yam Seng* stops some distance short of finding the existence of a general duty to act in good faith. It does however break new ground in so far as it is the first example (albeit at first instance) of the Court indicating willingness, in certain circumstances, to imply a term that the parties to a commercial contract are to act in good faith.

*When will an implied duty to act in good faith be found to exist?*

The test for finding the existence of an implied duty to act in good faith is the same as for any other implied term. In *Attorney General for Belize v Belize Telecom Ltd* Lord Hoffman held that: "*the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean*".<sup>36</sup>

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<sup>34</sup> [2013] EWHC 111 (QB) [120].

<sup>35</sup> *ibid.* at [131].

<sup>36</sup> [2009] UKPC 10 [21].



In *Yam Seng* Leggatt J held that 'the relevant background against which contracts are made includes not only matters of fact known to the parties but also shared values and norms of behaviour'. Those were stated to include "*honesty*"<sup>37</sup> and "*fidelity to a common purpose*".<sup>38</sup>

He observed that what good faith requires is sensitive to context before finding that in:

*"...some contractual contexts the relevant background expectations may extend... to an expectation that the parties will share information relevant to the performance of the contract such that a deliberate omission to disclose such information may amount to bad faith"*<sup>39</sup>

He then held that contracts which involve a long term relationships also termed 'relational contracts':

*"may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements."*<sup>40</sup>

*Yam Seng* therefore suggests that the 'context' will include whether the parties are in a relational contract or otherwise. Leggatt J identified three examples of relational contract (although not intended to be an exhaustive list): joint venture agreements, franchise agreements and long term distribution agreements.<sup>41</sup>

In *Acer Investment Management Ltd and another v Mansion Group Ltd*,<sup>42</sup> the Defendant asserted that as the contract provided for a distribution agreement, it was engaged in a relational contractual relationship. However, Laing J refused to accept that submission.

Instead, she found it material that the relationship was not exclusive, there were no obligations which one would expect in a relational contract and that neither party was required to spend significant sums in reliance on the continuation of the relationship.<sup>43</sup> This led her to accept counsel for the Claimant's submission that the idea that the contract was a relational contract was "*humbug*".<sup>44</sup>

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<sup>37</sup> [2013] EWHC 111 (QB) at [135].

<sup>38</sup> *ibid.* at [139].

<sup>39</sup> *ibid.* at [142].

<sup>40</sup> *ibid.* at [142].

<sup>41</sup> *ibid.* at [142].

<sup>42</sup> [2014] EWHC 3011 (QB).

<sup>43</sup> *ibid.* at [109].

<sup>44</sup> *ibid.* at [108].



*Acer Investment Management* indicates that the Courts will not adopt a formalistic approach to determining whether or not a contract is 'relational'. It also iterates some of those factors which will be relevant when the Court makes that determination

Unlike in *Acer Investment Management*, the Court in *Bristol Groundschool Ltd v Intelligent Data Capture Ltd and others* found that the contract was a relational contract.<sup>45</sup> This is the first decision to follow *Yam Seng* which found an implied duty of good faith and although the reasons why the contract was found to be relational are not given, it is clear that this finding was a relevant consideration in determining the existence of the implied duty.

Most recently, in *D & G Cars Ltd v Essex Police Authority*, the High Court found the existence of an implied term to act with 'integrity'. However, Dove J explained that he was using the word 'integrity' in much the same way as Leggatt J in *Yam Seng* had used 'good faith'.<sup>46</sup>

He then found that the 'contract created a relatively lengthy period of contractual relationship between the parties, during which there were going to be a very large number of individual transactions undertaken under the auspices of the contract'. This led the Judge to conclude that the contract was a "relational" contract *par excellence*'. Interestingly, Dove J also found it material that:

*"...the substance of the contract involved dealing with the recovered property of members of the public acting on behalf of a law enforcement agency. This required that the recovered property was itself treated with both honesty and integrity whilst it was being dealt with by the Claimant and they were exercising the requirements of the contract. Thirdly, and related to the second point, the property which was recovered and being handled by the Claimant might, in some instances, require return to the public and therefore its treatment whilst in the hands of the Claimant was of the utmost importance. Fourthly, some of the vehicles which were recovered under the specification of the contract would themselves form part of the evidence for criminal investigations and potential prosecutions in which they might become exhibits."*<sup>47</sup>

These three additional factors appear to go beyond the decision in *Yam Seng* in as much as they are not factors which relate to the relational nature of the contract, rather they are further factors which go to the nature or character of the underlying obligations.

In summary, the test for implying a duty to act in good faith into a commercial contract is no different to any other implied term and context is crucially important. In this regard whether the contract is 'relational in nature' is likely to be of critical significance. However, as D&G Cars makes

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<sup>45</sup> [2014] EWHC 2145 (Ch) at [196].

<sup>46</sup> [2015] EWHC 226 (QB) at [175].

<sup>47</sup> *ibid.* at [176].



clear this is not the only factor and the nature or character of the obligations provided for by the contract need to be fully considered in order to determine whether, when objectively assessed, the parties intended that their contractual relationship should be governed by a general duty of good faith.

### **Duty to negotiate**

A further interesting development in this area is in the law relating to a duty to negotiate in good faith. In *Walford v Miles*, the House of Lords appeared to exclude such a duty:

*"...the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms..."*<sup>48</sup>

However, in *Petromec Inc v Petroleo Brasileiro SA Petrobras (No 3)*<sup>49</sup> Manse LJ (as he then was) distinguished *Walford v Miles* on the basis 'that in [*Walford v Miles*] there was no concluded agreement at all since everything was "subject to contract"; there was, moreover, no express agreement to negotiate in good faith'.<sup>50</sup> In *Petromac* there was an express term in a complex agreement and Manse LJ held that in such circumstances the Court was not bound by the decision in *Walford v Miles*.<sup>51</sup>

More recently, in *Knatchbull-Hugessen and others v SISU Capital Ltd*<sup>52</sup> there was express provision for negotiations to be conducted in good faith during a six week exclusivity period. The Defendants sought to imply a term that the duty to negotiate in good faith extended beyond the exclusivity period and was to be implied as being in force during the currency of the negotiations.

Leggatt J rejected this submission on the basis that implication of such a term would be a plain case of rewriting the parties' bargain.<sup>53</sup> However, at no point does the Judge suggest that there is any legal difficulty in implying a term to negotiate in good faith as opposed to giving effect to an express term to negotiate in good faith in the manner contemplated in *Petromec*.

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<sup>48</sup> [1992] 2 AC 128 at 138.

<sup>49</sup> [2005] EWCA Civ 891.

<sup>50</sup> *ibid.* at [120].

<sup>51</sup> *ibid.* at [121].

<sup>52</sup> [2014] EWHC 1194 (QB).

<sup>53</sup> *ibid.* at [28].





A similar issue arose in *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd*<sup>54</sup> where Tear J had to address the question of whether a clause which required the parties 'to seek to resolve the dispute or claim by friendly discussion' for a period of four weeks prior to commencing arbitral proceedings was enforceable.

Tear J first held that a requirement to resolve a dispute by friendly discussions imported into the contract an obligation to do so in good faith and in doing so relied upon the established tests for implying a term into a contract.<sup>55</sup> The judge also relied upon Leggatt J's decision in *Yam Seng* (which he described as a 'masterly discussion') as well as decisions of the Courts of Singapore and New South Wales in arriving at this conclusion.

Tear J then held that such an obligation was enforceable. In doing so he distinguished *Walford v Miles* on the basis that it did not relate to a dispute resolution clause and that the distinction was material in light of public policy considerations.<sup>56</sup>

*Knatchbull-Hugessen* suggests that the Courts will enforce an obligation to negotiate in good faith and that there is nothing forensically wrong in seeking to imply such an obligation. *Emirates Trading Agency LLC* shows that an obligation to resolve a dispute by friendly discussions undertaken in good faith is enforceable and can, in appropriate circumstances, be implied into the contract. It is therefore suggested that when taken together, these two authorities suggest that the English Courts will, in principle, be willing to imply into a contract an obligation to negotiate in good faith when the context so requires.

### **Status of Yam Seng**

*Yam Seng* broke new ground in finding that an obligation to act in good faith could be implied into a commercial contract. It has been applied in *Bristol Groundschool Ltd v Intelligent Data Capture Ltd and others*; *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd* and most recently, in *D&G Cars v Essex Police Authority*.

It is however a first instance decision and one which has been distinguished on a number of occasions. In the *Medirest* case, the Court of Appeal did not need to address the question of whether a duty of good faith could be implied into a contract. Jackson LJ did however state:

"...I start by reminding myself that there is no general doctrine of "good faith" in English contract law, although a duty of good faith is implied by law as an incident of certain categories of contract: see Horkulak at para 30 and *Yam Seng Pte Ltd v International Trade*

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<sup>54</sup> [2014] EWHC 2104 (Comm).

<sup>55</sup> *ibid.* at [51].

<sup>56</sup> *ibid.* at [59]; [63].



Corporation Ltd [2013] EWHC 111 (QB) at paras 120 – 131. *If the parties wish to impose such a duty they must do so expressly.*"<sup>57</sup>

The final sentence of the cited passage would suggest that if parties wish to provide for a duty of good faith they *must* expressly provide for it. *A fortiori* there can be no implied duty to act in good faith.

Weighed against that observation is the fact that *Yam Seng* was cited by both Jackson LJ<sup>58</sup> and Beatson LJ<sup>59</sup> without criticism: a point noted by Richard Spearman QC sitting as a deputy High Court judge in *Bristol Groundschool* where he stated that he detected no element of disapproval of the decision in *Yam Seng* in the *Medirest* case.<sup>60</sup> Equally importantly (and as noted above), it is a decision which has now been followed on a number of occasions.

As a matter of precedent *Yam Seng* will be applied by any court of first instance unless that Court is persuaded that *Yam Seng* was wrongly decided.<sup>61</sup> Given the comments in the preceding paragraph, this seems unlikely and in those circumstances, it is suggested that until the matter is determined by the appellate courts, a duty to act in good faith, where the context permits, will be implied into commercial contracts governed by English law.

## Conclusion

English law's relationship with the doctrine of good faith appears to be changing over time. Whilst there is no general duty of good faith in English contract law, such an obligation is finding its way into commercial contracts both by its inclusion as an express term but also by implication.

On one view this is a welcome development. Party autonomy is enhanced by the Courts recognising and giving effect to the parties pre-contractual intentions. Equally, a duty to act in good faith promotes honesty and fair dealing between commercial operators which may, of itself, be seen as a *desideratum*.

Weighed against that is the uncertainty long associated with a duty to act in good faith. In *Yam Seng*, Leggatt J expressed the view that recognising a duty of good faith "*involves no more uncertainty than is inherent in the process of contractual interpretation*".<sup>62</sup> However, at least one senior member of the judiciary (speaking extra-curially) has expressed the view that this "*treats*

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<sup>57</sup>[2013] EWCA Civ 200 [105].

<sup>58</sup> *ibid.* at [105].

<sup>59</sup> *ibid.* at [150].

<sup>60</sup> [2014] EWHC 2145 (Ch) at [196].

<sup>61</sup> see *R v Greater Manchester Coroner Ex p. Tal* [1985] 1 QB 67 DC.

<sup>62</sup> [2013] EWHC 111 (QB) at [152].



*somewhat too lightly the problems of diminished certainty or the amount of time that might have to be spent in some cases in resolving disputes as to the application of the good faith clause*.<sup>63</sup>

It is respectfully suggested that this is correct. The content of a duty to act in good faith is entirely dependent on context and context will change on a case by case basis. However, it is open to parties to either exclude or define that duty and by careful drafting, any uncertainty can be minimised.

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<sup>63</sup> ‘Coming to Terms with Good Faith’ (Lecture at the Singapore Academy of Law, 26 April 2013) Lady Justice Arden.