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Good Faith Obligations in English Law

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Unlike many civil law jurisdictions in Europe, English law has generally not recognised an implied obligation that contractual parties should perform their obligations in good faith. English courts take the view that parties should have the freedom to contract in the way that they wish, and so have been reluctant to intervene and impose overriding obligations of good faith. However, in recent years, the position has somewhat shifted, and Scottish law and certain common law jurisdictions (such as Canada and Australia), have begun to recognise a principle of good faith in some circumstances.

Against this background, two recent cases have thrown the issue of good faith in English law back into the spotlight. In the light of these cases now, is it now possible that a good faith obligation could be implied into an English law contract?

A pair of recent cases about the issue of whether a general duty of good faith can be implied into an English law contract illustrate the continuing truth of Charles Dickens' maxim that "*The one great principle of English law is to make business for itself*". And, in a through-the-looking-glass twist of which Dickens' fellow Victorian Lewis Carroll would have approved, the court considering a contract without a good faith clause found itself prepared to imply a duty of good faith after all; whereas the court examining a contract actually containing such a clause did exactly the opposite and rejected the concept that a good faith doctrine exists in English law.

This leaves negotiators of commercial contracts in something of a quandary. Should they include a good faith clause at all, or should they expressly disclaim any duty to act in good faith towards the other contracting party (which would be an interesting negotiating position to have to justify across the negotiating table)?

THE GENERAL POSITION UNDER ENGLISH LAW

The general English law position in relation to an obligation to negotiate in good faith has long been that such a duty would be too uncertain to have binding force. Any attempt to assess damages arising out of a breach of such a duty would be incredibly difficult given that no one could know whether the negotiations would have been successful or not. Given that parties to a contract are on opposite sides of the negotiating table, any obligation imposed on these parties to carry on their negotiations in good faith would go against the adversarial nature of negotiations. Parties to a contract must be free to withdraw from negotiations, if they think it appropriate, or to threaten to withdraw in order to obtain improved contractual terms – *i.e.*, they should be free to pursue their own interests and not just to act in "good faith" toward the opposing party.

Furthermore, once a contract has been entered into, historically there has been no general duty to perform the contract in good faith under English law. In contrast, English law has tended to operate on a case-by-case basis whereby specific solutions are developed in response to certain problems of unfairness. Only in certain sectors has a fiduciary-type concept akin to good faith crept in. This includes, for example, consumer contracts (where

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the Unfair Terms in Consumer Contracts Regulations 1999 provide that a standard contract term, *i.e.*, one which has not been individually negotiated, is to be regarded as unfair if “contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract” (Reg. 5(1)) and commercial agency arrangements (whereby an agent must look after the interests of the principal and act in good faith).

Where a contract contains an express term requiring parties to act in good faith, the English courts have upheld such obligations - to a certain level. So, for example, in *Berkeley Community Villages Ltd and another v Pullen and others*, the court held that an obligation to act in “utmost good faith” required the parties to “observe reasonable commercial standards of fair dealing in accordance with their actions which related to the Agreement”. By contrast, in *Gold Group Properties Ltd v BDW Trading Ltd*, the court held that such an obligation would not “require either party to give up freely negotiated financial advantage clearly embedded in the contract”.

Ultimately then, the prevailing view of English courts that have considered arguments of good faith has been that, once a contract has been entered into, the parties will have freely negotiated its terms and therefore, unless expressly provided for, such a good faith duty should not be implied by the courts. Short of breaching a term of the contract, parties should be free to pursue their own self-interests. A potential implied requirement for good faith could, it would seem, create too much contractual uncertainty.

However, two recent cases have thrown this reasoning into doubt.

YAM SENG PTE LIMITED V INTERNATIONAL TRADE CORPORATION LIMITED (“YAM SENG”)

This case related to a distribution agreement between a product supplier (International Trade) and a Singapore-based distributor (Yam Seng). International Trade originally contacted Yam Seng in January 2009 and the parties signed an agreement in May 2009 relating to the distribution in duty free outlets of Manchester United branded perfumes and toiletries. After a series of arguments about prices and product delivery, the distributor, Yam Seng, terminated the agreement early claiming repudiatory breach of contract by International Trade.

The contract (governed by English law) made no mention of a duty of good faith. Nevertheless, Yam Seng pleaded as part of its case that there should be an implied contractual term that the parties would deal with each other in good faith.

Most cases dealing with good faith are based on the foundation of the comments of Lord Justice Bingham in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433. He said “*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’, ‘coming clean’ or ‘putting one’s cards face upwards on the table.’ It is in essence a principle of fair 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.*”

Consistent with this foundation, the court in the *Yam Seng* case held that English law is not at a stage where it recognises a requirement of good faith as a duty implied by law into all commercial contracts. Having repeated

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this apparently clear principle, the judge then held that a good faith duty can be implied “in an ordinary commercial contract based on the presumed intention of the parties”. And, on this “give with one hand, take with the other” basis, the judge agreed that some terms which Yam Seng had argued ought to be implied on the basis of good faith could indeed be implied, albeit via the indirect route of construction of the contracting parties’ intention.

Generally, a court may be prepared to imply a term if it considers that the parties intended that term to form part of their contract: the term must be so obvious that it goes without saying; necessary to give business efficacy to the contract; or something which “though tacit, formed part of the contract which the parties made for themselves”. Recently, this process has been expanded and implication has been analysed in relation to the construction of the contract taken as a whole, *i.e.*, what would the contract, read as a whole against the relevant background, reasonably be understood to mean? The relevant background would include “not only matters of fact known to the parties but also shared values and norms of behaviour”. Such norms could include “general social acceptance” or just be specific to that trade or industry.

The court in the *Yam Seng* case assessed the parties’ background in the course of assessing what could be implied in relation to good faith. The court stated that it would be hard to envisage any contract where honesty was not required in its performance. Hence good faith would, in almost every case, encompass honesty and, it was held, it would also include the observance of standards of commercial dealing. These are standards which go beyond honesty but are so generally accepted that the contracting parties would reasonably be understood to apply their provisions without explicitly stating them in the contract. Such standards would include not performing the contract in a way which is “improper” or “unconscionable”.

The court then considered factors which could be deemed to be part of “good faith” in certain scenarios. It held that, in certain scenarios, there may be an expectation that information would be shared: so, deliberate omissions of information may amount to bad faith rather than bad faith just being dishonesty. The court held that this would be particularly so in “relational contracts” in which long-term commitment, mutual trust and loyalty were present, *e.g.*, outsourcing or joint venture contracts, franchise agreements and long-term distributorship agreements (as was the case with *Yam Seng* and *International Trade*).

In arguing against the traditionally held view that the principle of freedom of contract prevents an obligation of good faith from being implied, the court held that the right approach is to address each case on its facts and consider whether good faith can be implied “through a process of construction of the contract”, *i.e.*, in accordance with the way the common law works. As the implication would be based on the parties’ intentions, and the context of the contract, no illegitimate restriction on the freedom of the parties was being put in place because the parties could modify the scope of any implied duty of good faith by express terms within the contract itself.

MID ESSEX HOSPITAL SERVICES NHS TRUST V COMPASS GROUP UK AND IRELAND LTD (TRADING AS MEDIREST) (“MEDIREST”)

This case concerned a catering contract between a hospital (the Trust) and a supplier (Medirest). Certain service levels were included within this contract and, when the catering service provided by Medirest did not meet these levels, the Trust awarded itself both service credits and service failure points (of which an accumulation of the latter would allow the Trust to terminate the contract). One reason for the attention that the case has attracted

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has been the eye-catching nature of some of the service credit deductions (for example, £84,000 for a chocolate mousse one day past its use-by date).

The contract between the Trust and Medirest also contained an express provision of good faith as follows:

“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 ... to derive the full benefit of the Contract”.

A dispute arose over which party had the right to terminate the contract but, in considering the issues in this case, the matter of whether the parties were under a general obligation to co-operate in good faith under the above provision also came into play.

When assessing whether there was a general duty to co-operate in good faith under the contract, the court held that the duty in this case was linked to the two purposes only, *i.e.*, on a matter of contractual interpretation, the duty to co-operate in good faith did not extend to a more general duty but rather only to enable “efficient transmission of information and instructions” and enable “the Trust...to derive the full benefit of the Contract”.

This case, although supporting *Yam Seng* in holding that the establishment of any duty of good faith would be objectively assessed and established through the process of construction of the contract, also shows that where a contract has an express provision of good faith and such a provision is linked to particular circumstances, no further implication will take place – the express provisions of the contract hold true. Furthermore, unless there is intent to the contrary, a narrow interpretation of such a provision is likely to occur.

CONCLUSION

In the *Yam Seng* case, the court in question was the High Court and so the specific issues in that case have not been subjected to higher judicial review. However, the points considered remain valid in relation to assessing whether an obligation of good faith could potentially be implied, and the case remains useful for clarifying the aspects which go together to make up good faith, as well as the importance of such an obligation in long-term, service-based “relational” contracts.

It appears that an obligation to perform contracts in good faith will not arise in every agreement but, if certain circumstances are present, the notion that no such term would ever be implied no longer holds true. In *Yam Seng*, it was made clear that good faith encompasses a number of aspects, of which honesty and adherence to certain standards of commercial dealing are consistent with recent interpretations of good faith and would be expected in almost every contract. Other terms, such as a higher level of communication and co-operation, may arise in unique circumstances including, as an example, long-term, service-based relational contracts. In each case, the contractual background of the parties will be highly relevant to what “good faith” is ultimately held to mean.

Ultimately then, it appears that the safest way for parties to establish whether an implied duty of good faith would be held to be present is to expressly provide whether such an obligation does or does not apply in the contract, given that any implied term of good faith would be established “through a process of construction of the contract”.

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In cases where contracting parties wish such an obligation to apply, they would be wise to specify the areas where such an obligation applies (as can be seen in *Medirect*). As always, when contracting, agreeing to positions from the outset and expressly providing for them in the contract, ensures that fewer disputes over uncertainties are likely to arise down the line.

Finally, one can speculate as to what may happen to a party brave enough to suggest a draft contract clause expressly disclaiming any obligation to act in good faith. While laudable from the standpoint of contractual clarity, one suspects that might be a contractual relationship not destined for eventual success.

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