Good faith in English law: what does it mean?

Although there is no established legal definition of what good faith actually means, the courts now accept that good faith provisions in contracts can be enforceable. Paul Giles and Emily Walling of Eversheds explain how the courts’ view has been developing.

There has traditionally been no established general concept of good faith in English law and it is usually only applicable to limited categories of contracts such as partnership agreements and agreements outlining a fiduciary duty. Recently, however, the courts’ views on good faith have been developing and, where good faith provisions have been ‘deliberately and expressly’ agreed by the parties, they have been held to be enforceable and relate to future conduct under that contract. (See Longmore J’s obiter comments in Petromec Inc v Petroleo Brasileiro SA Petrobras (No 3) [2005] EWCA Civ 891 that to hold the provision in a professionally drafted contract would ‘defeat the reasonable expectations of honest men’. However, Petromec was decided on other grounds and the general rule remains unchanged.) The courts have also found that good faith can be implied into the contract, although in certain very limited cases.

Express good faith obligations
The courts will give effect to express good faith provisions in contracts where they relate to performance of an obligation. The extent to which they are upheld depends on the wording of the clause. Clauses requiring the parties to act with the utmost good faith towards one another and reasonably and prudently at all times were held to be an obligation to adhere to the spirit of the contract, observe reasonable commercial standards of fair dealing, be faithful to the agreed common purpose and act consistently with the parties’ justified expectations (see Berkeley Community Villages Ltd v Pullen [2007] EWHC 1330 (Ch); CPC Group Ltd v Qatari Diar Real Estate Investment Co [2010] EWHC 1535 (Ch)). However, such an obligation does not require either party to give up a freely negotiated financial advantage.
in the contract (Gold Group Properties Ltd v BDW Trading Ltd [2010] EWHC 1632 (TCC)). The scope of such a clause will be dictated by the obligations to which it extends. In Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest) [2013] EWCA Civ 200, the parties’ contract required them to:

 ‘co-operate with each other in good faith [and] 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’.

The Court of Appeal held that this only related to the two stated purposes, not to all conduct under the contract. Similarly, the court in TSG Building Services plc v South Anglia Housing Ltd [2013] EWHC 1151 (TCC) held that the good faith obligation and co-operation was required for the performance of the contract, but not the unqualified and unconditional express right to terminate.

Perhaps most surprising to practitioners will be the recent Court of Appeal decision to enforce cl 10.1 of NEC3, though it is not strictly a good faith obligation. In Northern Ireland Housing Executive v Healthy Buildings (Ireland Ltd) [2014] NICA 27, the Court of Appeal applied cl 10.1 of the NEC3 contract to the language of cl 61.1 to conclude that the employer was bound to give written notification of a compensation event which it admitted to be an instruction. This is perhaps the first in a new line of cases that give effect to a good faith style clause when directly linked with other obligations in the contract.

Implied good faith obligations?

Traditionally, it has been very difficult to argue that a duty of good faith should be implied into an English law contract. However, it is now clear that such a duty may be implied. In Yam Seng PTE Ltd v International Trade Corp Ltd [2013] EWHC 111 (QB), Leggatt J outlined that honesty, fidelity to the parties’ bargain, cooperation and observance of common commercial standards have already been generally accepted as possible implied terms in English courts if the circumstances demand it. Leggatt J concluded that these distinct implied terms could cumulatively amount to an implied duty of good faith that could be implied into a ‘relational contract’. He noted that such 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.’

Certain construction and engineering contracts could fall into the category of ‘relational’ contracts such as long term framework contracts or major projects where the contract requires regular, frequent and open communication.

The Court of Appeal in Medirest considered Yam Seng when deciding whether there was an implied term that the employer would not act in an arbitrary, irrational or capricious manner in assessing the contractor’s performance. The Court of Appeal reiterated that there is no general doctrine of good faith in English contract law and that to impose such a duty, it must be express. The court did not, however, overrule Yam Seng.

This could be due to the distinct differences between the cases in terms of the complexity of the contracts and the alleged implied terms. The ‘complicated contract’ in Medirest was split over four documents and the Court of Appeal focused on the extent of discretion that could be exercised by the employer. It concluded that there was no justification for an implied term of good faith due to the limited nature of the discretion; there were precise rules to calculate deductions and the employer’s decision was limited to whether or not to exercise its absolute contractual right.

On the other hand, Yam Seng involved a ‘skeletal document’; the court noted that it would be harder to imply terms into a detailed and professionally drafted contract. When considering whether there was an implied term to act in good faith, the court looked at two more specific terms: a duty not to give false information, which could not be implied, and a duty not to undercut duty free prices, which could be implied as the parties would have expected that their obligations would reflect the industry assumption. Thus, the conclusion in Yam Seng was specific to the facts of that particular arrangement.

Yam Seng has been considered in later cases: (1) Hamsard 3147 Ltd (t/a Mini Mode Childrenswear) v Boots UK Ltd [2013] EWHC 3251 (Pat) confirmed that there is no implied positive obligation on a party to subordinate its own commercial interests to the other party’s. (2) In Greenclose Ltd v National Westminster
Bank plc [2014] EWHC 1156 (Ch), the court referred to Yam Seng noting that it did not lay down any general principle applicable to all commercial contracts.

The court also highlighted that the more discretion afforded to a party, the more readily the court will imply an obligation that the discretion should not be exercised in bad faith or in an arbitrary or capricious manner, although it would be heavily dependent on context.

One of the issues in Bristol Groundschool Ltd v Intelligent Data Capture Ltd [2014] EWHC 2145 (Ch) was whether there was an implied duty of good faith in the contract and, if so, whether the claimant had breached that duty. The judge agreed with the defendants that the parties’ agreement (not a complex contract) was a ‘relational’ contract of the kind referred to in Yam Seng and that the agreement contained an implied duty of good faith.

When referring to Medirest, the court noted that there had been ‘no element of disapproval’ of Yam Seng.

The court in Bluewater Energy Services BV v Mercon Steel Structures BV [2014] EWHC 2132 (TCC) considered a complex offshore construction project. The contract required the parties to:

‘uphold the highest standards of business ethics in the performance of the contract. Honesty, fairness and integrity shall be paramount principles in the dealings between the parties’.

Two of the issues were whether Bluewater was entitled to reject Murcon’s requests for variations for failure to comply with the notice requirements and whether Bluewater had validly terminated the contract in light of the discretion afforded to it under the contract. The court decided that there was an implied limitation on Bluewater’s ability as decision-maker:

‘by reference to concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality’.

That implied limitation was consistent with the contract but existed even without the express words. On the facts, the court held that the variations were valid and that the contract had been validly terminated.

In Brogden v Investec Bank plc [2014] EWHC 2785 (Comm), Leggatt J considered the discretion exercised in calculating an employee’s bonus scheme and concluded:

‘where a contract gives responsibility to one party for making an assessment or exercising a judgement on a matter which materially affects the other party’s interests and about which there is ample scope for reasonable differences of view, the decision is properly regarded as a discretion which is subject to the implied constraints that it must be taken in good faith, for proper purposes and not in an arbitrary, capricious or irrational manner […] where the decision is final and binding on the other party.’

The justification for the implication of the term was to give effect to the presumed intention of the parties. Consequently, it is possible, in limited circumstances, to successfully argue that a duty of good faith can be implied into an English law contract.

As Court of Appeal authority, Medirest takes precedence over the High Court decisions in Yam Seng, Bristol Groundschool, Bluewater and Brogden. Thus the starting position for all English law contracts is that there is no general doctrine of good faith. The implication of such a term can only be in specific circumstances which are unlikely to arise in construction/engineering contracts which are often extremely extensive and detailed contracts not dissimilar to those in Medirest (although the discretion afforded to the decision-maker will be a key consideration).

Relevance to construction and engineering projects

Construction/engineering projects are often governed by ‘relational contracts’ into which good faith obligations might be implied following Yam Seng, Bristol Groundschool, Bluewater and Brogden. The complexity of a contract will need to be balanced against the ‘relational’ nature of the contract to determine whether or not a term should be implied. Express good faith-style obligations are quite common in bespoke English law construction/engineering contracts in certain sectors, though the wording varies significantly between industries. The courts have recently indicated a willingness to give effect to good faith style clauses in commercial and construction contracts, whereas previously the enforceability of such provisions wasn’t evident. Establishing a clear link between the good faith provision and a positive obligation appears to be key to the question of enforceability. Accordingly, the wording of each good faith provision needs to be construed carefully to determine true meaning; careful drafters should ensure that the good faith obligation extends as narrowly or widely as they intend. CL