Good faith in English law

What does it mean?

Recent cases dealing with good faith provisions in contracts have important ramifications for the construction industry

What is good faith?

Many countries have good faith as a concept in their civil code such that it applies to all contracts (whether expressly included in a contract or not). For example, the European Court of Justice has referred to good faith as a “principle of civil law” and the proposed Common European Sales Law includes a definition of “good faith and fair dealing” as “a standard of conduct characterised by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question”.

In France, the Civil Code relating to contract implementation includes good faith provisions. This extends to the duty of the contractor to advise the employer, the obligation being of different magnitude depending on the strength of the parties’ knowledge. This is not exclusive to Europe; in Japan, one of the Fundamental Principles of the Civil Code is that “The exercise of rights and performance of duties must be done in good faith”.

However, English law is a common law system, and is not based on a civil code. This means that the position is far less clear in English law and is dependent on precedent. In recent years the issue of good faith has been under the spotlight and this article examines what good faith means in English law in light of recent case law.

In English law, good faith has been summarised as not simply meaning that the parties “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.”

At least until recently, there has been no established general concept of good faith in English law and the concept of good faith is usually considered only applicable to limited categories of contracts such as partnership agreements and agreements outlining a fiduciary duty such as insurance contracts.

As a result, English lawyers have commonly advised that an argument based on breach of either an express or implied good faith principle would be very unlikely to succeed – whilst a good faith provision in a contract may be nice to have, it has often been considered to be a toothless provision.

However, in recent years the English 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.

English Courts have also found that good faith can be implied into the contract – though only in certain very limited cases. Set out below is an analysis of the recent case law in England on the effect of both express and implied good faith provisions.

1 C-489/07 Messner v Krüuger (2009) E.C.R. I-7315
4 http://www.moj.go.jp/ENGLISH/ccr/CCR_00001.html
5 Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd (1989)
6 See Longmore J’s obiter comments in Petromec Inc v Petroleo Brasileiro SA Petrobras (No. 3) (2005) where he stated that to hold the provision in a professionally drafted contract would “defeat the reasonable expectations of honest men”. However, the Petromec decision was made on other grounds and the general rule remains unchanged.
Express obligations to act in good faith

The cases below seem to indicate a pattern that English courts will give effect to express good faith provisions in contracts as long as they relate to actual performance of some obligation. The extent to which they have been upheld has varied depending on the exact wording of the clause, so it is helpful to look at some examples:

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<tr>
<th>Case</th>
<th>Clause</th>
<th>Decision</th>
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<td>Berkeley Community Villages Ltd v F Pullen [2007]</td>
<td>“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”</td>
<td>This was held to be an obligation “to observe reasonable commercial standards of fair dealing in accordance with their actions which related to the Agreement and also requiring faithfulness to the agreed common purpose and consistency with the [party’s] justified expectations.”</td>
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<td>CPC Group Limited v Qatar Diar Real Estate Investment Company [2010]</td>
<td>The parties “shall both act in the utmost good faith towards each other in relation to the matters set out in this Deed” and “use all reasonable but commercially prudent endeavours to enable the achievement of the various threshold events and Payment Dates”.</td>
<td>This was interpreted as an obligation to:</td>
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<td>Gold Group Properties Limited v BDW Trading Limited (formerly known as Barratt Homes Limited) [2010]</td>
<td>The agreement required the parties to “observe and perform their respective obligations” and “at all times act in good faith” for all transactions entered into between the parties.</td>
<td>The court held that “whilst requiring the parties to act in a way that will allow both parties to enjoy the anticipated benefits of the contract, [the good faith obligation] does not require either party to give up a freely negotiated financial advantage clearly embedded in the contract”. The claimant was found not to be in breach of the good faith obligation in refusing to accept or even negotiate proposals which were of no financial interest to it. Had it refused to negotiate where it was unaffected financially by the changes and where the negotiations were necessary to permit the agreement to be performed as envisaged, it might well have been in breach of the obligation.</td>
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<td>Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest) [2013]</td>
<td>“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.”</td>
<td>Overturning the High Court decision, the Court of Appeal held that, although the good faith clause was valid and the demanded payments were excessive, the obligation did not stretch to all conduct under the contract and did not constrain the operation of the payment mechanism. Instead, it was an obligation to work together honestly endeavouring to achieve the two stated purposes. The judgment concluded: “care must be taken not to construe a general and potentially open-ended obligation such as an obligation to “co-operate” or “to act in good faith” as covering the same ground as other, more specific, provisions, lest it cut across those more specific provisions and any limitations in them.” *As a Court of Appeal case, this is the leading case on good faith obligations in English law.</td>
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<td>TSG Building Services plc v South Anglia Housing Limited [2013]</td>
<td>“The Partnering Team members shall work together and individually in the spirit of trust, fairness and mutual co-operation for the benefit of the Term Programme, within the scope of their agreed roles, expertise and responsibilities as stated in the Partnering Documents, and all their respective obligations under the Partnering Contract shall be construed within the scope of such roles, expertise and responsibilities”.</td>
<td>The court found that the good faith clause did not extend to acting reasonably when terminating the contract; the good faith obligation was restricted to those expressly listed actions. Co-operation was required for the performance of the contract, not its termination and the good faith obligation did not cut across the unqualified and unconditional express right to terminate.</td>
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<td>Fujitsu Services Limited v IBM United Kingdom Limited [2014]</td>
<td>Schedule 2 to the parties’ contract required them to have regard to the partnering principles in carrying out their obligations under the contract which noted that all dealings should be “open, honest, clear and reliable” and that the parties should “Work together to achieve a relationship of mutual respect and trust”</td>
<td>The court held that there was no express duty of good faith in the clauses relied upon by Fujitsu and that the partnering principles lacked contractual certainty. The parties agreed only to “have regard to” those principles, which the court considered were “aspirational and motivational”. The parties appeared to have chosen deliberately to avoid an express agreement that they would owe a duty of good faith and that choice should be respected.</td>
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Accordingly, when seeking to determine the effect of an express good faith (or similar) obligation, the English Courts will closely examine the wording in the agreement and will only hold that the wording binds the parties to those expressly stated obligations, not to the whole contractual relationship and not to limit other contractual rights or entitlements. Generic wide ranging provisions may be considered ineffective because of uncertainty.

**Implied good faith obligations?**

Traditionally, for the reasons outlined above it has been very difficult to argue that a duty of good faith could or should be implied into an English law contract.

However, whilst the difficulty with such an argument almost certainly remains, a number of recent cases have indicated that, in certain circumstances, an implied duty of good faith can exist in English law contracts.

In the recent case of Yam Seng PTE Ltd v International Trade Corporation Limited [2013] EWHC 111 (QB), the judge outlined that honesty, fidelity to the parties' bargain, cooperation and observance of common commercial standards have all already been generally accepted as possible implied terms in English Courts if the circumstances surrounding a contract demand it (looking at the shared values and norms of behaviour) and these distinct implied terms could cumulatively be seen as amounting to an implied duty of "good faith".

The judge in Yam Seng said such obligations could be implied into a contract where the contract is a "relational contract", noting 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."

This case therefore provides authority that a duty of good faith can be implied into "relational" contracts; into which category certain construction and engineering contracts could fall (for example, on long term framework contracts or major projects where the form of contract used requires regular, frequent and open communication).

In the Medirest case (referred to above), the Court of Appeal considered Yam Seng when deciding whether there was an implied term in Medirest that the employer would not act in an arbitrary, irrational or capricious manner in assessing the contractor's performance. However, the Court of Appeal reiterated that "there is no general doctrine of good faith in English contract law [...] If the parties wish to impose such a duty they must do so expressly".

The Court of Appeal did not, however, overrule Yam Seng as being bad law. 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 contract in Medirest was a "complicated contract" split over four documents. In Mid Essex, the Court of Appeal focused on the extent of discretion that could be exercised by the employer and 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 as to how the deductions should be made 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"; in Yam Seng 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 that the parties would deal with each other 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.
More recently, in Greencloase Limited v National Westminster Bank plc [2014] EWHC 1156 (Ch) it was noted 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.

Further, in Bristol Groundschool Ltd v Intelligent Data Capture Ltd and others [2014] EWHC 2145 (Ch), one of the issues before the court was whether there was an implied duty of good faith in the contract and, if so, whether the claimant had breached that duty by downloading materials from the defendants’ IT systems without authorisation.

The defendants argued that the agreement between the parties was a hybrid between a joint venture and product distribution agreement such that it was sufficient to import an implied duty of good faith following Yam Seng. The judge agreed that the parties’ agreement 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 the Court of Appeal decision in Medirest, the court noted that there had been “no element of disapproval” of Yam Seng. This case therefore demonstrates that the courts are willing to imply a good faith obligation into a contract. However, again the court was not dealing with a complex contract.

In the case of Bluewater Energy Services BV v Mercon Steel Structures BV, Mercon Holding BV, Mercon Groep BV [2014] EWHC 2132 (TCC), the English Technology and Construction Court considered a complex project relating to the construction of a mooring system for an offshore oil field. Clause 33.1 of 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 under consideration were whether the claimant was entitled to reject the defendants’ requests for variations for failure to comply with the notice requirements and whether the claimant 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 the claimant’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 clause 33.1 of the contract but existed even without those express words. On the facts, the court held that the variations were valid (notwithstanding any failure to comply with the notice requirements) and that the contract had been validly terminated.

Consequently, it does appear possible (albeit in limited and special circumstances) to successfully argue that a duty of good faith can be implied into an English law contract.

However, under the precedent system Medirest, as Court of Appeal authority, takes precedence over the High Court decisions in Yam Seng, Bristol Groundschool and Bluewater. The starting position for all English law contracts therefore remains that there is no general doctrine of good faith in English contract law. The implication of such a term can only be in very particular circumstances, which are unlikely to arise in construction/engineering contracts (though note the Bluewater case indicating there may be exceptions to the general rules).

**Why is this relevant to the construction and engineering industry?**

Construction/engineering projects are often governed by “relational contracts” into which good faith obligations might be implied following Yam Seng, Bristol Groundschool and Bluewater, though they are often extremely extensive and detailed contracts not dissimilar to those in Medirest. If the contract contains no express reference to good faith, following the leading Court of Appeal authority of Medirest, attempts to rely on implied duties of good faith will remain very difficult (but not impossible). The complexity of a contract will need to be balanced against the “relational” nature of the contract in order to determine whether or not an implied term is really a necessity.

Nonetheless, there are a number of standard form English law contracts (which are also used internationally) with express good faith-style obligations such as acting “in a spirit of mutual trust and co-operation” or working “in a co-operative and collaborative manner in good faith and in the spirit of trust and respect.” Further, 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 wording of each provision needs to be construed carefully to determine true meaning.

Consider if the following situations are subject to a good faith obligation:

- a quotation for a variation or further works is issued which does not appear to be a genuine commercial offer
- a quotation or a programme is rejected for lack of inessential details

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7 NEC3 standard form of contract
8 JCT CECEPTA, 2011
In the first instance the unrealistic offer might not be a breach of good faith as it is unlikely that a court will find there is an implied positive obligation on a party to subordinate its own commercial interests to those of the other party. In CPC Group (referred to above), the court did not consider bad faith to be a pre-requisite of evidence of a breach of good faith, but noted that it would be difficult to find such a breach without bad faith or at least ill-will. In Yam Seng, the court highlighted that this was an objective test: would the conduct be regarded as commercially unacceptable by reasonable and honest people?

In that context, the second example may be a breach of good faith particularly further to Bluewater, in which the court noted that any discretion should be exercised with the implied limitation of honesty, good faith and genuineness and an absence of arbitrariness, capriciousness, perversity and irrationality.

It is worth noting that the Bluewater case noted above may provide limited support to arguments against the application of time bar/notice provisions now commonly found in international construction contracts (but again, the wording of the contract will be crucial). In Bluewater, the court noted that mere reliance on a notice clause which gives one party a discretion to allow or disallow a claim is not sufficient. There must be an impact on that party resulting from the late provision of, or incomplete, information; otherwise it would be an abuse by that party.

In conclusion, if you agree to a good faith obligation in a contract, it should be clearly stated and only relate to the specific obligations to which the parties intend it to relate. Careful drafters will include clear wording particularly when dealing with key issues such as management of change. Parties should always comply with and be entitled to enforce those provisions, notwithstanding any good faith obligation. The English Courts consider the parties’ agreement to be of primary importance and wider duties will not lightly be implied, particularly where they contradict express terms.

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