



Welcome to the July edition of *Insight*, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

**In this issue we discuss the recent approach of the courts to good faith and the implications for commercial practice.**

# Insight

## Do contracting parties have a duty to act in good faith under English law?

The reluctance of the courts to imply terms into agreements negotiated between two commercial parties at arm's length is well known and is based on the long-established doctrine of freedom of contract.

That said, the courts are on occasion prepared to imply terms into contracts in circumstances where the concluded contract is not clear. In such cases, the courts will consider what the contract would reasonably be understood to mean as a whole against the relevant contractual background, and in light of the knowledge that was reasonably available to the parties at the time the contract was entered into.

Since February 2013, two High Court judgments and one Court of Appeal judgment have been handed down that examine the role of good faith in English law and the extent to which circumstances under which the English courts might recognise an overarching duty of good faith. All these cases took as their starting point the fact that there is no legal principle of good faith under English contract law.

This twenty-fifth issue of *Insight* considers the recent approach of the courts to good faith and the implications for commercial practice.

### What is good faith?

The concept of good faith is subjective and depends very much on the overall terms of the contract and the commercial context, but good faith essentially means being honest and "playing fair".

A deliberate failure to share information that is objectively relevant to the performance of the contract, for example, would undoubtedly amount to a breach of good faith in the case of a long-term contract such as a joint venture which requires the parties to work together. Good faith would not automatically apply to clauses that involve an element of discretion, but it may apply to clauses that involve an assessment or choice as to a range of options to which the interests of both parties are relevant.

### Recent case law

#### *Yam Seng – February 2013*

In *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB), the parties entered into a contract under the terms of which ITC granted Yam Seng an exclusive agreement in respect of the distribution of fragrances bearing the name "Manchester United". The relationship between the parties broke down and proceedings were brought by Yam Seng for breach of contract and misrepresentation.

Yam Seng asserted that it was an implied term of the contract that the parties would deal with each other in good faith. Specifically, Yam Seng argued that ITC had (i) failed to act with an implied obligation of good faith by prejudicing Yam Seng's sales by offering the same products for domestic sale below the duty free prices that Yam Seng was permitted to offer; (ii) instructed or encouraged Yam Seng to incur marketing expenses for products that ITC was unable or unwilling to supply; and (iii) offered false information upon which Yam Seng relied to its detriment. There were no express terms of the contract covering any of these points.

On the facts, only two obligations were implied. Firstly, the court found there was an obligation not to undercut duty free prices, and secondly, there was an obligation not to knowingly provide false information, and a duty of good faith was implied in both these respects. The first obligation was contrary to usual standards of commercial dealing and the second was implied into the agreement between the parties as a matter of fact.

The judge, Leggatt J, had various reasons why he saw fit to imply these two terms. In the main, it was necessary for terms to be implied because the contract was skeletal in form, it had not been professionally drafted and it did not take into account an important industry assumption that duty free prices would be lower than domestic retail prices, which was common ground between the parties at trial.

Leggatt J also commented *obiter* that the contract was a long-term distributorship agreement which required the parties to communicate effectively and cooperate with each other in its performance. Accordingly, there would probably have been an implied obligation upon ITC to keep Yam Seng informed of ITC's best estimate of when products would be available for sale and to inform Yam Seng of any material change in this information without Yam Seng having to ask.

#### *Compass – March 2013*

In *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200, the parties entered into a long-term facilities contract under the terms of which Compass agreed to provide catering services to the Trust.

The contract contained a duty to cooperate in good faith at clause 3.5, which provided:

*"The Trust and the Contractor will cooperate 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."*

The question before the court was the extent to which this clause provided an overarching obligation on the parties to operate with each other in good faith even though there was no standalone express term to this effect in the contract. The contract as a whole was very detailed and the obligations of the parties and the consequences of any failures were spelt out in explicit detail. The obligation to act in good faith specifically focused on the obligation to take all reasonable action as was necessary for the efficient transformation of information and instructions.

Accordingly, the Court of Appeal overturned the decision of the first instance court in finding that commercial common sense did not favour the addition of an overarching duty to cooperate in good



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faith in circumstances where good faith had been provided for in the contract in such a precise manner at clause 3.5.

The Trust was not therefore prevented from awarding service failure points for failures in performance as the contract expressly contained precise rules for these matters. Further, it did not matter that the Trust deducted £84,540 for a one-day out-of-date chocolate mousse. The ability of the Trust to award service failure points for poor performance was an absolute contractual right.

The Court of Appeal emphasised that if the parties had wished to impose an overarching duty of good faith, they should have done so expressly.

*TSG - May 2013*

*TSG Building Services plc v South Anglia Housing Ltd* [2013] EWHC 1151 (TCC) is probably the most important of the three cases to the construction industry because it concerns the implication of terms into an ACA Standard Form of Contract for Term Partnering (TPC 2005, amended 2008).

TSG contracted with SAH to provide gas servicing and an associated works programme in respect of SAH's housing stock. Clause 1.1 of the contract provided:

*"The Partnering Team members shall work together and individually in the spirit of trust, fairness and mutual cooperation for the benefit of the Term Programme..."*

SAH terminated the contract and TSG argued that termination was wrongful and in breach of clause 1.1. The issue the court had to decide was whether the good faith clause was pervasive such that it applied to the whole contract.

On the facts, there was no suggestion in the clause that the obligation to act in good faith extended to all aspects of the contract. Indeed, it would not be appropriate for a duty of good faith to apply to each and every obligation within the contract. If this was the case, the good faith clause would potentially have the effect of undermining other clauses in the contract that conferred

rights on the parties, contrary to the parties' intention.

The court did however accept that, in principle, an express obligation to act in good faith could be pervasive and, depending on the nature and drafting of the clause, it may be possible for it to affect all aspects of the contract.

However, this was not the case here as the contract contained an unqualified right to terminate the contract for convenience at sub-clause 13.3 to which the obligation to act in good faith could not possibly extend. SAH had an absolute entitlement to terminate the contract for any or no reason. The judge, Akenhead J, emphasised that the termination for convenience clause did not contain an element of responsibility. The entitlement to terminate the contract was absolute and it was obvious to each party that they were entitled to terminate at any time. The court also followed the Court of Appeal in *Compass* in refusing to find that there was an implied duty of good faith.

Everything turned on the drafting of the good faith clause. If the good faith clause had involved an element of discretion, it would have been much easier for the court to conclude that good faith should apply to the exercise of that discretion. But that was not the case here.

### So what does this all mean in practice?

Should you include an express obligation to act in good faith in your contract?

The answer is probably that the existence of an obligation to act in good faith does not necessarily guarantee that the parties *will* act in good faith. This is because contracts cannot be expected to provide for every eventuality or be shaped to suit the peculiarities of every commercial relationship. The key to a successful contract is a reasonable attitude, both in the interpretation of any contract provisions that might be unclear, and also in the approach taken by the parties to any other differences of opinion which, if dealt with reasonably and courteously, should not lead to the development of a formal dispute.

Some may argue that the inclusion of an express provision to act in good faith might imply a lack of trust between the parties, which may have the effect of setting the commercial relationship

off on completely the wrong footing. However, this is probably more of a concern than a reality. There are already contracts founded on the concept of good faith, for example the NEC form which obliges the parties to act in a "spirit of mutual trust and co-operation".

The key question is whether or not there is an overarching duty of good faith? This is something the courts have yet to find, although parties should bear in mind that the existence of an express good faith clause may provide a standard against which their own actions may be measured.

Placing the theory aside, if you think it would be advantageous to include an express obligation to act in good faith in your contract, you should ensure that it is drafted carefully so that the extent of the obligation, particularly in relation to the rest of the contract, is clear.

### Conclusion

We are not yet at the stage where the English courts are ready to imply upon contracting parties a duty to act in good faith, as is the case in most civil codes. But this is not unexpected as the current approach of the courts is consistent with the general principle of English contract law that a term will not be implied into a contract if it would be inconsistent with an express term of the contract.

Instead, the courts prefer to consider what the contract would reasonably be understood to mean as a whole against the relevant contractual background, and in light of the knowledge that was reasonably available to the parties at the time the contract was entered into.

If parties wish to impose a contractual duty of faith they should do so expressly and in very clear terms.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston. [lkingston@fenwickelliott.com](mailto:lkingston@fenwickelliott.com). Tel +44 (0) 207 421 1986

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