

# Good Faith in English Contract Law

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## Summary

Under English law, there is no general doctrine of good faith. This means that there is no general obligation to act in good faith during the negotiation of commercial contracts. The exceptions to this rule include where (a) the contract contains an express duty of good faith; (b) there is a contractual discretion and a term of good faith may be implied; or (c) the agreement in question is a 'relational' contract giving rise to an implied term of good faith. The term that will be implied will depend on the express provision in question, and the contract as a whole.

## Express duty

Parties are free to negotiate the terms of their contractual arrangements. Accordingly, an express duty of good faith will arise if the words used in a contract impose such a duty. This approach has been confirmed by the English Courts.<sup>1</sup>

The scope of an express duty of good faith should be defined in the contract to avoid uncertainty. The Court of Appeal has found that an express duty of good faith will not necessarily apply to the contract as a whole. The duty of good faith may only apply to specific areas of the contract where the express term has been included.<sup>2</sup>

A duty of good faith has no universally accepted meaning and will be highly dependent on the commercial context in which it appears. In this context, a good faith provision will likely be enforceable if it is: an express agreement to negotiate in good faith contained in a binding agreement; and the scope of the provision is narrow and capable of being ascertained by a third party.

## Duty of rationality?

It is a general principle of English law that contractual rights are enforceable regardless of whether they have been exercised 'reasonably'.<sup>3</sup> Nevertheless, recent authority from the English Court suggests that where there is a contractual discretion it should be exercised in good faith:

1. In *Abu Dhabi National Tanker Co v Product Star Shipping Ltd (The 'Product Star')* (No. 2), Lord Justice Leggatt found that where a discretion is granted “not only must the discretion be exercised honestly and in good faith, but, having regard to the provisions of the contract by which it was conferred, it must not be exercised arbitrarily, capriciously, or unreasonably.”<sup>4</sup>
2. More recently, in *Braganza v BP Shipping Ltd* the duty of rationality was established by the Supreme Court. Under the “Braganza” duty, “a contractual discretion must be exercised in good faith and not arbitrarily or capriciously. This will normally mean that it must be exercised consistently with its contractual purpose.”<sup>5</sup>

The duty of rationality will likely arise when one party, acting as decision-maker, is afforded a discretion to make a decision or assessment on a matter that affects one or more parties, giving rise to a potential conflict of interest.

### **An implied duty of good faith?**

For a term to be implied, the following conditions must be met:

- a. it must not contradict the rest of the contract;
- b. it must be necessary to give business efficacy to the contract;
- c. it must be obvious; and
- d. it must be capable of clear expression.<sup>6</sup>

In 2015, the Supreme Court clarified how this test should be applied:

- a. the Court is concerned with what reasonable people in the position of the parties at the time of contracting would have done;
- b. a term should not be implied because a court considers it fair;
- c. demonstrating reasonableness is not likely to be sufficient to imply a term;
- d. the requirements for business necessity or that a term should be “obvious” are not cumulative;
- e. a term can only be implied if without it, the contract would lack commercial or practical coherence.<sup>7</sup>

In this context, an implied duty of good faith is only likely to arise where the strict test for implying a term is met, and specifically the contract would lack commercial or practical coherence without it.<sup>8</sup>

### **Relational contracts**

The Courts have applied different approaches when considering the scope for implying good faith

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obligations in a contract.

In *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 QB, the High Court found that there was an implied term of good faith which had been breached. In his decision, Mr Justice Leggatt (as he was then known) focused particularly on relational contracts finding that in those contracts, there is likely to be an implied term of good faith. The decision in *Yam Seng* was later given cautious approval by the Court of Appeal.<sup>9</sup> Accordingly, *Yam Seng* is authority for the premise that where a contract is 'relational' there may be an implied duty of good faith.

Where there is a relational contract, as a matter of law, there will be an implied duty of good faith. The question then arises, as to when a contract is 'relational'. In *Bates v Post Office Ltd (no 3)*<sup>10</sup> Mr Justice Fraser provided guidance on this point, and identified nine characteristics of a relational contract:

- a. the term of the contract is long or it is intended to be long term even if it lacks a fixed term (however it is not clear what constitutes a 'long term' contract);
- b. the parties intend their roles to be performed with integrity and with fidelity to their bargain;
- c. the parties are committed to collaborating with each other;
- d. the spirit of the contract cannot be expressed exhaustively (i.e. the objectives could not all be written down);
- e. the parties hold trust and confidence in one another;
- f. there is a high degree of co-operation and an expectation of loyalty;
- g. there is no express term preventing a duty of good faith being implied;
- h. one or both parties have made a significant investment; and
- i. the relationship between the parties is exclusive.

These criteria could apply to many types of commercial contracts. PFI contracts, franchise agreements, and joint venture arrangements have been found to be 'relational contracts'. However, whether a contract will be classified as a 'relational contract' depends on the facts and context.

Some academics have expressed scepticism regarding relational contracts as a category and the Courts have also been slow to embrace the concept. For example, in *UTB LLC v Sheffield United Ltd* the High Court criticised the approach in *Bates* because it considered that the test for an implied term had been applied in reverse order.<sup>11</sup> Mr Justice Fancourt determined that the test for a relational contract should begin with looking at the express terms. The implied duty of good faith can only apply where it is needed to give the contract commercial or practical coherence. In relation to references to good faith in boilerplate provisions, the High Court has found that this amounts to an indication that the parties have exhaustively defined the extent of any good faith obligations, so that no wider duty of good faith should be implied.<sup>12</sup> Yet, Lord Justice Leggatt, more recently reiterated his stance from *Yam Seng Pte* in *Sheikh Al Nehayan v Kent* where a long-term joint venture to develop hotels and an online travel business was a relational contract subject to an implied duty of good faith as a matter of

## When will a duty of good faith be implied?

A recent string of cases provide some indication on the approach which the Courts may adopt:

1. In *TAQA Bratani Ltd & Ors v RockRose UKCS8 LLC* the argument that a Braganza type term should be implied or that a joint operating agreement was a relational contract subject to an implied term of good faith did not succeed.<sup>14</sup> His Honour Judge Pelling pointed out that the joint operating agreements in question were sophisticated and detailed commercial contracts drafted by professionals, “therefore the starting point and in all probability the end point in the construction exercise will be (a) the natural and ordinary meaning of the provision being construed, (b) any other relevant provisions of the contract being construed and (c) the overall purpose of the provision being construed and the contract in which it is contained.”
2. Similarly, in *Cathay Pacific Airways v Lufthansa Technik AG* the Claimant argued that the option to exercise a right of removal of particular aircraft engines from a maintenance programme, should be treated as subject to a Braganza type implied term.<sup>15</sup> Alternatively, the Claimant contended that the contract was a relational contract and so should be subject to a general duty of good faith. John Kimbell QC, sitting as a Deputy Judge of the High Court, held that no term was to be implied on either basis, principally because the language of the contract was clear.
3. On the other hand, in *UK Acorn Finance Ltd v Markel (UK) Ltd* the commercial contract in question was a professional indemnity insurance policy.<sup>16</sup> It contained an unintentional non-disclosure clause. The question arose as to whether a Braganza type limitation was to be implied into the non-disclosure clause. His Honour Judge Pelling looked at the express terms first, in context, and then considered whether it was necessary to imply a term. He held, like the clause in *Braganza*, the nondisclosure clause rendered one party to the contract (the underwriters) a contractual decision-maker who was given a discretion to form an opinion on the facts. To make the clause work, and to reflect the parties’ obvious but unexpressed intentions, the Court held that a term was to be implied. That term was that underwriters would not exercise their decision-making powers pursuant to the non-disclosure clause arbitrarily, capriciously or irrationally.

## Concluding remarks

There is no clear and predictable approach as to whether a term of good faith will be implied into a contract and what the scope of a good faith obligation will be. It remains to be seen whether the elevation of Lord Justice Leggatt to the Supreme Court may result in English law soon recognising the concept of good faith in line with civil law systems, and the US and Australia. Good faith is a question that must be considered at the time of drafting the contract. For a good faith obligation to be more likely to be enforceable, it should be (i) part of a legally binding agreement; (ii) express rather than implied; and (iii) capable of objective assessment by a third party, for example by having a narrow and clearly defined scope.

## Footnotes

1. Petromec Inc v Petroleo Brasileiro SA Petrobras (No. 3) [2005] EWCA Civ 891
2. Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Trading Ltd [2013] EWCA Civ 200
3. White & Carter (Councils Ltd) v McGregor [1962] AC 413
4. [1993] 1 Lloyd's Rep. 397
5. [2015] UKSC 17
6. BP Refinery (Westernport) Pty Ltd v Shire of Hastings (1977) 52 ALJR 20
7. Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited [2015] UKSC 72
8. Monde Petroleum SA v Westernzagros Ltd [2016] EWHC 1472 (Comm)
9. Globe Motors v TRW Lucas Varity Electric Steering Ltd [2016] EWCA Civ 396
10. [2019] EWHC 606 (QB)
11. [2019] EWHC 2322 (Ch)
12. Teesside Gas Transportation v CATS North Sea [2019] EWHC 1220 (Comm)
13. [2018] EWHC 333 (Comm)
14. [2020] EWHC 58
15. [2020] EWHC 1789 (Ch)
16. [2020] EWHC 922 (Comm)

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