Duty of good faith in contract under English law: recent developments

As a matter of English law, the orthodox view is that there is no duty of good faith in dealings between contracting parties. The reasons given for the absence of a legal principle of good faith include: the importance of the parties being free to contract on specific terms and to act in their own self-interest; and the uncertainty that would be created if express obligations had to be construed applying a vague notion of good faith.

Civil law systems

In many civil law systems, there is a general overriding principle that parties should act in good faith when negotiating and performing contracts. Obligations of good faith are also to be found in varying degrees in contractual relationships governed by the laws of countries adopting common law systems such as the United States of America and Australia.

English law has instead developed solutions on a case-by-case basis such as estoppel and the concept of the reasonable man. Further, as a matter of English law, a duty of good faith will be implied into certain contracts such as those where the relationship between the parties is fiduciary in nature.

The impact of EU law

The Unfair Terms in Consumer Contracts Regulations 1999, giving effect in the UK to the European Directive, includes a requirement of good faith. Further, in a commercial context, Council Directive of 16 February 2011 on combating late payment in commercial transactions refers to good faith concepts (Article 7(1)(a)).

Yam Seng: an implied duty of good faith?

In a recent case before the English court, Yam Seng Pte Limited v International Trade Corporation Limited [2013] EWHC 111 (QB), Mr Justice Legatt considered that it would benefit English law to adopt the concept of good faith in the performance of contractual obligations. Yam Seng Pte Limited (“Yam Seng”) and International Trade Corporation Limited (“ITC”) had entered into a distribution agreement pursuant to which ITC granted Yam Seng the exclusive rights to distribute certain products bearing the brand name “Manchester United” in specified
territories in the Middle East, Asia, Africa and Australasia. Over time, the relationship between the parties deteriorated and ultimately Yam Seng informed ITC that it was treating the contract as at an end due to repudiatory breach by ITC. Yam Seng claimed damages for breach of contract for, amongst other things, failing to make products available for distribution by Yam Seng and damages in tort relying on misrepresentations said to have been made prior to the distribution agreement being entered into. The distribution agreement was governed by English law.

One of the arguments relied on by Yam Seng was that it was an implied term of the contract that the parties would deal with each other in good faith. Mr Justice Legatt noted that the general view among commentators was that in English contract law there is no legal principle of good faith of general application. He commented that he doubted English law had reached the stage where it was ready to recognise a requirement of good faith as a duty implied by law into all commercial contracts, but he considered there was no difficulty in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties. He expressed the view that there was nothing novel to English law in recognising an implied duty of good faith in the performance of contracts when it involves a consideration of whether the particular conduct would be regarded as commercially unacceptable by reasonable and honest people (i.e. an objective rather than a subjective test).

Mr Justice Legatt concluded by respectfully suggesting that the traditional English hostility towards the doctrine of good faith in the performance of contracts was misplaced. He referred to the reasons generally given for the reluctance on the part of the English court to recognise the doctrine. He considered that because the content of the duty was established through a process of construction of the contract, its recognition was entirely consistent with the case-by-case approach favoured by common law. He also expressed the view that the concern that recognising a duty of good faith would generate uncertainty was misplaced because its application involved no more uncertainty than is inherent in the process of contractual interpretation in any event.

Although Mr Justice Legatt considered that English law ought to imply a general duty of good faith into the performance of commercial contracts, it seems that he did not think that English law had reached the stage where it was ready to do so as a matter of course. In Yam Seng, Mr Justice Legatt implied a good faith requirement into an ordinary commercial contract based on the presumed intention of the parties. He held that ITC was in breach of contract for acting in bad faith in misleading Yam Seng about certain steps said to have been taken by ITC.

**Mid Essex v Compass: a restatement of the orthodox view?**

The question of whether as a matter of English law it is necessary for a contracting party to exercise their rights and perform their obligations in good faith was considered again recently by the Court of Appeal in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest)* [2013] EWCA Civ 200, although in the context of a contract that contained an express obligation to co-operate in good faith. The appeal was from a judgment of Mr Justice Cranston.

One of the main points on appeal was the effect of an express obligation on the parties to co-operate in good faith to enable Mid Essex Hospital Services NHS Trust (“the Trust”) to derive the full benefit of the contract. The issue was whether the wording of the particular clause was to be construed
as imposing a general obligation on both parties to act in good faith (as Mr Justice Cranston had found), or as imposing an obligation to co-operate in good faith for two specific stated purposes: the efficient transmission of information and instructions and to enable the Trust to derive the full benefit of the contract. The argument in favour of the second interpretation was that it was a detailed contract which identified the obligations of the parties and commercial common sense did not favour a general overarching duty to co-operate in good faith.

In giving his judgment, Lord Justice Jackson started by reminding himself that there was no general doctrine of good faith in English contract law, although a duty of good faith would be implied by law as an incident of certain categories of contract. If the parties wished to impose such a duty, it was necessary to do so expressly. He construed the relevant clause more narrowly than Mr Justice Cranston and held that it only imposed an obligation on the parties to work together honestly to try to achieve the two stated purposes and that there had been no breach of the obligations set out in the clause, with the effect that Medirest had not been entitled to terminate the contract when it purported to do so. Lord Justice Jackson referred to the Yam Seng case but only to highlight the paragraphs of the judgment of Mr Justice Legatt that summarised the English court’s general reluctance to adopt a legal principle of good faith of general application to contracts, the reasons cited for that reluctance and the specific categories of contracts where a duty of good faith had been implied.

Lord Justice Beatson, in giving a short judgment, added some observations about the express good faith clause and in doing so referred to the Yam Seng case. However, he simply noted that Mr Justice Legatt had given extensive consideration to the question of implying a duty of good faith into a contract and stated that the same considerations would apply to the interpretation of an express obligation to act in good faith. He emphasised the need to construe the express obligation to co-operate in good faith in light of the specific wording of the clause, the other provisions of the contract and its overall context. He concluded: “In a situation where a contract makes such specific provision, in my judgment 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.”

The Court of Appeal did not expressly disapprove the ruling by Mr Justice Legatt in Yam Seng and did not need to do so given it was dealing with an express rather than an implied obligation of good faith. The judgment is, however, a restatement of the orthodox view that, whilst English law will respect and enforce an express obligation in a contract to act in good faith, it will do so restrictively in the context of the contract as a whole and will not readily imply a more general duty of good faith.
TSG Building v South Anglia

The ruling in Yam Seng and the Court of Appeal judgment in Mid Essex were both considered recently by Mr Justice Akenhead in TSG Building Services Plc v South Anglia Housing Limited [2013] EWHC 1151 (TCC). South Anglia Housing Ltd ("South Anglia"), a housing association company, contracted with TSG Building Services PLC ("TSG") for the provision of a gas servicing and associated works programme relating to South Anglia’s housing stock. South Anglia terminated the contract and one of the issues before Mr Justice Akenhead was the interpretation of the clause relied on by South Anglia in terminating the contract. The issue was whether the clause as a matter of construction provided for any constraint or qualification on what was apparently an unfettered right of either party to terminate for convenience. TSG argued that a term should be implied that the parties should act in good faith in exercising their rights under the termination clause.

Mr Justice Akenhead referred to a number of authorities in relation to the implication of terms into contracts, which emphasise that terms will only be implied in limited circumstances. Having quoted from the judgment of Mr Justice Legatt in Yam Seng, Mr Justice Akenhead concluded: “Because cases and contracts are sensitive to context, I would not draw any principle from this extremely illuminating and interesting judgment which is of general application to all commercial contracts.” In this case, Mr Justice Akenhead refused to imply a good faith obligation in the contract in the exercise of the right to terminate without cause and noted that, even if there was some implied term of good faith, it could not circumscribe what the parties had expressly agreed.

Comment

Although this is a developing area of law, it seems that the traditional orthodoxy is alive and well for the moment and that the English courts will not readily imply an obligation to act in good faith in the performance of a contract. If parties intend to enter into a contract governed by English law and wish the parties to be subject to such an obligation, they should include an express term to this effect. They should be aware, however, that any such clause is likely to be construed strictly.

The English courts are likely to remain reluctant to imply a general duty of good faith in relation to pre-contractual negotiations, relying instead on other remedies available to the parties such as misrepresentation and duress. The concerns about implying a duty of good faith in relation to the performance of a contract would seem to apply with more force to pre-contractual negotiations. An obligation to negotiate in good faith would seem to be little more than an unenforceable agreement to agree. In addition, it would be very difficult to assess whether negotiations (even if conducted in good faith) would have resulted in an agreement being reached, or what the terms of that agreement would have been, to enable an assessment of damages. The comments of Mr Justice Legatt in Yam Seng related to the implication of a good faith term to the performance of contractual obligations and not in pre-contractual negotiations.