
Can we rely on good faith in contractual relationships?

Mohammed Ahmed, associate director at Currie & Brown, evaluates the effectiveness of relying on good faith in contractual relationships within the construction industry.

Introduction

The short answer is that it would depend on a number of factors. Unfortunately, there is no simple answer to this, but there are good reasons as to why this is the case. This article will explore these reasons and the legal provisions that parties can rely upon and the extent to which these are applied by the English courts¹ at pre- and post-contract signature stages.

It is perhaps worth noting the English courts are resistant to the notion of an implied duty of good faith. In other words, rather than requiring persons to act in good faith as a default, English courts prefer to adopt the incremental development of a particular solution to broad principles – this is known as the “piecemeal solution”². Simply put, the courts will assess the extent to which good faith applies (if any), depending on the issue at hand and through the use of case law or precedent, whereas under the civil law system the default position is that in making or carrying out a contractual obligation parties must act in good faith.

To add to the mix, parliament enacted several statutory provisions that need to be considered by the English courts when deciding upon the application of good faith. These provisions include the Unfair Contract Terms Act 1977 (now Consumer Rights Act 2015), the Sale of Goods Act 1979 (as amended by the Supply of Goods and Services Act 1982), and other applicable acts – some of these have been derived from EU legislation (which is a civil law system).

An implied obligation?

The English courts have taken the position on the implied duty of good faith following the decision in *Walford v Miles [1992]*. In this case, the court decided that within a contractual setting (when parties are negotiating), parties are in an adversarial struggle for gain and, therefore, some “cards” must remain unshown, otherwise the competitive edge, or gain, is lost. Moreover, the concept of good faith is subjective, and one party’s view may differ from another. Trying to nail this down was considered unworkable. Instead, the English courts rely on the doctrines of misrepresentation, duress and onerous terms, brought in by statutory provision and case law, to address unfairness.

There could, however, be instances when parties *may* be expected to act in good faith as an implied duty. In *Thornton v Shoe Lane Parking Ltd [1971]*, it was held that a party is required to make the other reasonably aware of any onerous conditions of contract before entering into the contract. This may amount to inferring an implied obligation to act in good faith, ie taking reasonable steps to make the other party aware. However, despite this, courts are still reluctant to decide that such duty amounted to good faith on the premise that there are other remedies available to the claimant.

A decision of the High Court in 2014 confirmed that an implied duty to negotiate in good faith was unenforceable. In this case³, the claimant agreed an exclusivity period of six weeks in which the parties would negotiate in good faith and would not contract with other parties.

¹ usually covers Wales; the system in Scotland is somewhat different as the basis of law is founded upon the civil law system and, therefore, reference will only be made to the English courts.

² *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989]*.

³ *Knatchbull-Hugessen & Ors. v SISU Capital Ltd [2014]*

Following the expiry of the exclusivity period, the claimant contracted with a third party and the defendant refused to pay its legal cost for the negotiation during that period, arguing that the claimant had an implied duty to continue negotiating and not to contract with a third party. The court ruled that while the duty to act in good faith was an express provision pertaining to the six weeks, after this period the agreement lapsed and so did the requirement to act in good faith, and an implied duty under English cannot be enforced per *Walford v Miles* [1992].

An express term under the contract

The aforementioned case touched upon express versus implied terms/duties, with the former taking precedence; of course, this may be nuanced with statutory provisions, which may be implied into contracts in the absence of express wording or misrepresentation, etc. With negotiated contracts, ie those that have been signed, a similar principle applies with respect to good faith. In *Myers v Kestrel* [2015], the court held that implying such duty is not required, provided that there is extensive contractual machinery to govern the parties' conduct, ie the express provisions within the contract are sufficient to understand the obligations of the parties and will take precedence over any implied obligations.

Moreover, where the contractual machinery falls short of interpreting contractual requirements, there are other remedies that the courts may use in place of implying the duty of good faith. These may include pre-contractual negotiations⁴ to determine the intentions of parties (by way of reading against the contract to give meaning to the contract) per *Chartbrook v Persimmon Homes* [2009].

As with all decisions by the courts, there are always exceptions that need to be considered. When concerning long-term or relational contracts (these may include construction/engineering contracts), the courts will consider the understanding of the parties at the time of the dispute rather than relying solely on express terms, because over time the meaning of an express term may change (as compared with the original intent) per *Yam Seng v International Trade Corp* [2013]. Additionally, the court held that 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.

From the above cases, we have established that an express term will normally override any implied obligation, including the duty of good faith. However, it is worth understanding how this mechanism works and the extent to which it applies to contractual obligations, noting that a contract may have different obligations that require to be fulfilled at different times.

Even if the express provisions within a contract provide for the parties to act in good faith, this does not necessarily mean that it would apply to the entirety of the contract, notwithstanding that some contracts may be entire contracts, ie the contract containing all the obligations/agreements between the parties. So how does it work?

In *Mid-Essex NHS Trust v Compass Group* [2013], the contract contained a clause requiring the parties to act in good faith. When the trust terminated the long-term agreement because the service provider's performance fell below the agreed threshold, the service provider resisted the notice and stated that the serving was in breach of the good faith obligation. The court, however, found in favour of the trust on the basis that while there was express provision within the contract for good faith, it did not apply to the serving of the termination notice; the notice was served as a consequence of poor performance which is governed under the machinery within the contract.

⁴ Normally these would be inadmissible.

Similarly, in *TSG Building Services Plc v South Anglia Housing Ltd [2013]*, an express provision, independent of others, existed that allowed termination of the contract at any time provided three months' notice was given. There was also an existing express provision for acting in good faith. When the termination notice was served by South Anglia Housing, it was resisted by TSG on the basis that South Anglia Housing did not act in good faith on serving the notice. The court found in favour of South Anglia Housing and held that the good faith provision did not apply to the termination clause, which was independent of other clauses. The good faith obligation only applied to the provision of information and not the entire contract. For such requirements to apply there needs to be express wording within the contract to that effect.

Where do construction contracts stand?

Whether contracts are specifically designed for the construction industry or any other industry, the law governing the contract would apply just the same, including the decisions of the court in the cases mentioned in this paper.

Construction contracts have evolved over time, the JCT suite is currently in its 2016 version and the commonly used versions are the design and build and the standard building contract. However, it is only in the design and build version that reference to good faith is made. Clause 5 places an obligation on parties to work "...in a co-operative and collaborative manner, in good faith and in a spirit of trust and respect". Further, under clause 10 additional obligations are placed on parties to attempt to resolve matters in "good faith negotiations". These two clauses are independent of each other and apply in different settings.

Similarly, the NEC4 form has been amended slightly and the good faith obligation now follows more closely the typical requirements set out in civil codes. The wording under the PPC2000 form follows that of the NEC3 form in relation to good faith.

Despite the presence of these clauses, the manner in which they operate or apply, ie to which clauses, is not clear cut; the wording of each provision needs to be construed carefully to determine true meaning.

Under the FIDIC form, there is no mention of the duty of good faith, and for good reason. FIDIC is generally used in civil law countries where there are statutory requirements that would imply that duty. Similarly, if the JCT or NEC contracts were to be used in civil law countries, the overriding legal obligation would equally apply (the references to good faith under JCT and NEC may be nullified if they contradict the statutory provisions).

Conclusions

The reasons for not having in place a statutory requirement for good faith is that the English courts prefer to develop solutions on a piecemeal basis, per *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989]*. However, this position may be nuanced by *Yam Seng v International Trade Corp [2013]* in which the courts held that 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.

Against this background, therefore, it would seem that it is better or easier to rely on the good faith provision, provided this is expressly provided for within the contract at hand. Moreover, the wording relating to it must be clear in that it must specify the extent to which it is intended to apply, provided it does not contravene the Unfair Contract Terms Act 1977 or any other act.