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Good Faith, Trust and Co-operation

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Stephen Furst Q.C.

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Clause 10.1 of NEC 3 Engineering and Construction Contract provides:

> *"The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and co-operation."*

Clause 2.1 of the JCT Constructing Excellence Contract 2007 states:

> *"The Overriding Principle guiding the Purchaser and the Supplier in the operation of this contract is that of collaboration. It is their intention to work together with each other and with all other Project Participants in a co-operative and collaborative manner in good faith and in the spirit of mutual trust and respect. To that end the Purchaser and Supplier agree that they shall each give to, and welcome from, the other, and the other Project Participants, feedback on performance and shall draw each other's attention to any difficulties and shall share information openly at the earliest practicable time. They shall support collaborative behaviour and address behaviour that does not comply with the Overriding Principle."*

Do clauses such as these give rise to real, hard enforceable rights and obligations or are they merely pious words to encourage a collaborative attitude.

In the field of construction the collaborative approach was endorsed and promoted by Sir Michael Latham in 1994, particularly in his report "Constructing the Team". He appeared to believe that what he perceived as the inherently adversarial approach in the industry could be, at least to some extent, reduced by the introduction of clauses into construction contracts such as those set out above. Unfortunately Sir Michael gave no guidance as to what such clauses might mean in practice or how they might modify the adversarial approach.

The concept of good faith as an incident of commercial life dates back as an explicit concept in English common law to the 18th century, although it has origins in Roman and possibly in pre-Roman law. Thus Lord Mansfield could refer to good faith as "the governing principle....applicable to all contracts and dealings." And that "Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary. But either party may be innocently silent, as to grounds open to both, to exercise their judgment upon."[1]

Thus good faith, collaboration and fair dealing has pervaded almost every aspect of our law. Courts are used to be making evaluative judgements on normative concepts.

In the statutory context, for example:

1. The Unfair Contract Terms Act 1977.

2. Regulation 4 of the Unfair Terms in Consumer Contracts Regulations 1994[2] whereby an "unfair term" is a term contrary to the requirements of good faith.

[1] Carter v Boehm (1766) 3 Burrow 1905.
[2] The Director General of Fair Trading v First National Bank plc [2001] UKHL 52. See also Westminster Building Co Ltd v Beckingham [2004] EWHC 138 (TCC).

3. Under Section 8(1) of the Late Payment of Commercial Debts (Interest) Act 1998 where the court is required to assess whether a contract provides a "substantial remedy".[3]

At common law, for example:

1. Whether an insured has provided details in utmost good faith to the insurer;

2. Similarly contracts for partnership require a would-be partner to disclose all material facts of which he has knowledge and the other partners might not be aware.[4]

3. Whether an agreement is voidable for economic duress where the person said to be exerting pressure has not acted in good faith.[5]

4. It is said that the so-called duty on contractors to warn designers of defects of design is simply an incident of this general good faith obligation.[6]

[3] See for example Yuanda (UK) Ltd v WW Gear [2010] BLR 29.
[4] Conlon and another v Simms [2008] 1 WLR 484.
[5] DSND Sub-Sea v Petroleum Geoservices [2000] BLR 530.
[6] Plant Construction plc v Clive Adams Associates (1999).

5. In connection with obligations to resolve disputes "in good faith" and whether proceedings should be stayed to permit or require such attempts at resolution to take place.[7]

6. As to whether terms of an unusual or onerous nature have fairly been brought to the attention of the other contracting party.[8]

In more general terms the emphasis on co-operation and partnership is evident in the formulation of the overriding objectives of the CPR with the requirement placed on the parties to co-operate in helping the court of further those objectives.[9] Thus the courts now expect the parties to engage in mediation in good faith and in the field of construction the availability of adjudication is evidently intended to limit expenditure on disputes.

Thus we should approach clauses such as the present as intending to give rise to real and enforceable obligations. However there are formidable difficulties.

The problem of providing a definition of "good faith" is evident from the discussion in *Walford v Miles*[10]. There a lock-out agreement for negotiations for the sale and purchase of a company was said to be subject to an implied term that the parties would negotiate in good faith. This was rejected on the basis that that such a term lacks the necessary

[7] Cable & Wireless plc v IBM United Kingdom Ltd [2002] EWHC 2059 (Comm Ct).
[8] Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1987] 1 QB 433.
[9] CPR Rule 1.3.
[10] [1992] 2 AC 128. See also Ultraframe (UK) Ltd v Tailored Roofing Systems Ltd [2004] EWCA Civ 585.

certainty. Thus, it was said, the court would be unable to determine whether a party had acted in bad faith given that the parties are essentially in an adversarial position and entitled to pursue its own interest.

By contrast in *Petromec and others*[11] the contract provided that the parties would negotiate certain extra costs and extra time "in good faith". Whilst that issue did not have to be decided Longmore LJ was clearly of the view that such an obligation was enforceable. However in that case the court would have been able to determine the extra costs involved since they were simply the reasonable costs of certain work which could be objectively ascertained. The court accepted that a problem might arise as to when and in what circumstances negotiations had been brought to an end in bad faith. In the event this was not thought likely to pose a problem since an allegation of fraud was going to be made and this would or was likely to overtake any dispute of bad faith. *Walford v Miles* was distinguished on the basis that in that case, unlike *Petromec*, there was no concluded agreement (the agreement was "subject to contract") and there was no express term to negotiate in good faith.

Somewhat closer to home is the decision in one of the *Multiplex* cases.[12] There the parties agreed to "use reasonable endeavours to agree to re-programme the completion of the subcontract works and to agree a fixed lump sum and/or reimbursable subcontract sum for the completion of the subcontract works...". Following *Walford v Miles* Jackson J.

[11] [2005] EWCA Civ 891.
[12] [2006] EWHC 1341 (TCC).

held that the clause was to uncertain to impose a contractual obligation and was merely a statement of aspirations.

There is little English authority on the content of an express obligation of good faith. In *Interfoto* Bingham LJ stated:

> *"In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they 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 and open dealing."*

In *Berkeley Community Villages*[13] Mr Justice Morgan had to decide whether a sale of land to a third party, which would deprive the claimant of the opportunity to earn fees, would breach an express term of the agreement: *"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".*

The Judge construed this obligation as *"imposing on the Defendants a contractual 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 justified expectations of the First Claimant."* But in the event he held the Defendants were not in breach.

[13] [2007] EWHC 1330 (Ch).

In *Gold Group Properties Ltd*[14] I had to decide whether the Claimant had failed to observe a clause which provided that *"Barratt and the Freeholder will observe and perform their respective obligations and the conditions set out in the Second Schedule and will at all times act in good faith"* in circumstances where it was said that the freeholder ought to have agreed an amendment to the revenue sharing arrangements on a proposed development in the light of the downturn in the property market. I held : *"... good faith, whilst requiring the parties to act in a way that will allow both parties to enjoy the anticipated benefits of the contract, does not require either party to give up a freely negotiated financial advantage clearly embedded in the contract."*

However in Australia good faith plays a much greater role in commercial life. In part this is due to statutory intervention:

Section 51AC(1) of the Trade Practices Act reads as follows:

> *"(1) A corporation must not, in trade or commerce, in connection with:*
>
> *(a) The supply or possible supply of goods or services to a person (other than a listed public company) or*
>
> *(b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);*
>
> *(c) engage in conduct that is, in all the circumstances, unconscionable."*

[14] [2010] EWHC 1632 (TCC).

By Section 51AC(3) the Court may have regard to various matters set out in that provision including whether any undue influence or pressure was exerted on the business consumer, the extent to which the supplier's conduct was consistent with its conduct in similar transactions, the requirements of any applicable industry code, and the extent to which the supplier and the business consumer acted in good faith.

The development at common law in Australia has followed similar lines. *Overlook v Foxtel*[15] concerned an agreement whereby Overlook agreed to supply certain TV channels which were to be sold by Foxtel to consumers as part of TV subscriptions. Overlook was to receive a percentage derived from the sales of these channels to Foxtel customers. In order to increase its penetration Foxtel decided to reduce the price of subscriptions which, at least in the short term, would reduce Overlook's income under the agreement. Overlook sought damages, in part based on breach of an implied term obliging Foxtel to act in good faith towards Overlook should Foxtel decide to change the prices charged to subsribers.

The New South Wales Supreme Court decided that an obligation of good faith is implied by law into commercial contracts of this nature. The content of the obligation was described as:

> *"(1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);*

[15] [2002] NWSC 17.

(2) compliance with honest standards of conduct; and

(3) compliance with standards of conduct which are reasonable having regard to the interests of the parties"

Developing these criteria it was said: *"A party is precluded from cynical resort to the black letter. But no party is fixed with the duty to subordinate self-interest entirely which is the lot of the fiduciary.....The duty is not a duty to prefer the interests of the other contracting party. It is, rather, a duty to recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms. In many ways, the implied obligation of good faith is best regarded as an obligation to eschew bad faith."*

In the event it was held that Foxtel had not breached the implied term.

However in *Pacific Brands Sport & Leisure*[16] it was said: *"the duty of good faith is an incident (not an ad hoc implied term) of every commercial contract, unless the duty is either excluded expressly or by necessary implication. The duty cannot override any express or unambiguous term which is to a different effect. Further, I presently incline to the view (but not with complete conviction) that the duty is not an independent term of the contract the breach of which would give rise to a remedy, but that it operates as a fetter upon the exercise of the discretions and powers created by the contract, including the power of termination.....I appreciate that the standard of conduct imposed by a covenant of good faith is incapable of precise definition. That does not produce an unworkable obligation. There are many instances to be found in the law of contract and elsewhere of obligations that are incapable of clear definition. Reference need only*

[16] [2005] FCA 288.

be made to the obligation of reasonableness that pervades so much of our law. Be that as it may, a good starting point in any particular enquiry is to see whether the impugned conduct (in this case a termination) was motivated by bad faith, or was for an ulterior motive or, if it be any different, whether the defendant acted arbitrarily or capriciously. It may also be proper to investigate whether the impugned act was oppressive or unfair in its result. If any of these things can be established then, in all probability, the obligation will be breached and the resultant act (or omission) of no effect."

In *Automasters Australia*[17] the franchisor terminated a franchise for breach of the franchise agreement. The Judge's findings as to whether there had been a breach are not easy to disentangle. It would appear that he found that there had been certain minor breaches but not such as *"would be sufficient to justify a termination of the contract"* : *"I am not satisfied that the plaintiff can be said to have been reasonable in the formation of its opinion that a default had occurred. There was obviously a degree of ambiguity in the circumstances as to the state of alleged non-compliance. This ambiguity had been the subject of the 22 January audit and from that point on, in view of the finding I have made in favour of Mrs Coombes' version of the meeting, the plaintiff was on notice that a degree of doubt surrounded the accuracy of its lists. Accordingly, in my view, the plaintiff cannot be said to have formed an opinion reasonably about the state of default if, in the circumstances, it simply proceeded to issue the default schedule without prior reference to the defendants."*

Clause 15.1 of the agreement provided:

[17] [2002] WASC 286.

> *"The Franchisor will use its best endeavours to promote the performance and success of the Franchise Business and will deal at all times with the Franchisee in absolute good faith."*

The Judge considered the content of this obligation in these terms:

> *"It is apparent from the decided cases and related discussion that an express term concerning good faith, either in negotiation or in performance, is likely to be considered certain and the term will be interpreted to give it meaning. What constitutes good faith will depend on the circumstances of the case and upon the context of the whole of the contract. The Courts will allow normal and reasonable business behaviour, with the result that the parties are not obliged to put aside their own self-interest or proprietary rights. A court considering such a provision is entitled to have regard to the reasonableness of the conduct and whether a party has acted unconscionably or capriciously. This may require the court to give some consideration to the motivation underlying the relevant events.....The content of the term is to be established by reference to the contract as a whole and the nature of the franchise arrangements. That being so, it was not open to the franchisor to exercise its rights and powers unreasonably or capriciously, although it was entitled to have regard to its own commercial self-interest. This all suggests that the plaintiff was not at liberty to rely upon technical or minor infringements unless it was able to point to a clear and persistent course of misconduct."*

Thus the franchisor breached the agreement by purporting to terminate based on minor infringements of the franchise agreement and the franchisee recovered damages.[18]

Whilst these authorities concentrate on good faith, in my view similar principles apply in relation to obligations to co-operate and act in a collaborative manner or on the basis of mutual trust. In *Birse Construction Ltd v St David Ltd*[19] the parties entered into a Charter

[18] For further Australian authority see Bropho v Human Rights & Equal Opportunity Commission [2004] FCAFC 16 and in Hong Kong: Hyudai Engineering and Construction Co. Ltd v Vigour Ltd CACV 128/2004.
[19] [1999] BLR 194.

whose aim was: *"To produce an exceptional quality development within the agreed time frame, at least cost, enhancing our reputations through mutual co- operation and trust."* Whilst this Charter had no binding effect it was held that the terms *"are important for they were clearly intended to provide the standards by which the parties were to conduct themselves and against which their conduct and attitudes were to be measured."*

English law has long eschewed the adoption of abstract overriding concepts, at least at common law, in favour of pragmatic development on the particular facts of cases. However there is a clear tide of opinion favouring a more co-operative attitude between parties whether their relationship is contractual or adversarial. Such authority as there is suggests that the courts will attempt to give real content to a "good faith" or equivalent obligation but it is suggested that the courts in England would be unlikely to imply a term to this effect, as a matter of law although it might be said to be an incident of an implied term of co-operation and/or non-hindrance.

It is easy to see that insofar as a contract provides for the exercise of a discretion or a power by a party a court can give content to an express "good faith" obligation, at least to the extent of requiring such a discretion not to be exercised or power invoked in bad faith. More difficult are cases where no such discretion or power is involved. However an important feature is whether and to what extent such terms can require a party to have regard to the commercial interest of the other party. As the law presently stands such a consideration might be relevant at the margin, that is to say as a matter assisting interpretation of the express terms whilst not contradicting any such terms. The

interesting point however is that such terms do require a court to consider whether hard-edged commercial advantage has to be subsumed to the joint enterprise as evident from the terms of the contract.

Thus NEC3 may well prevent an employer exercising the right of determination in circumstances where, for example, it can be shown the employer wishes merely to get the work done more cheaply where the breach is remediable and minor. Thus, for example, suppose the Contractor failed to provide a bond within the time limit specified by the contract. This would be a termination event under Core Clause 91.2. Suppose also that there was evidence to show that the Contractor was in the course of obtaining the bond and the delay had been due to a cash flow problem resulting from delay in the assessment of the Contractor's entitlement under the Contract by the PM and that the Employer was aware of these matters. It is suggested that it would at least be arguable that a determination in such circumstances would breach the obligation of mutual trust and co-operation in Core Clause 10.1.

More difficult would be a case where the Contractor fails to notify the Project Manager of a compensation event which the Project Manager was not obliged to notify the Contractor of but of which he was aware. Could it be said that failing to assess the compensation event was a breach of the obligation of co-operation? Probably not. The general obligations to act in a collaborative manner cannot dilute the "hard edged" and clear agreements of the contract, they probably operate only at the margin or, as set out above, in connection with discretions and powers.

The JCT contract appears to go further. Thus, it is suggested, that all the obligations under the contract are to be interpreted in the light of the overriding principle.

I foresee increasing reliance on "good faith" obligations in litigation; certainly to criticise the exercise of powers and discretions by the other contracting party and Project Manager/Engineer/ Architect. At the very least such obligations reinforce the usual implied terms of co-operation and non-hindrance and, in appropriate cases, may well go further.

Stephen Furst Q.C. **September 2010**

Keating Chambers,
15 Essex Street
London
WC2R 3AA