



GOOD FAITH, HONESTY, AND REASONABLENESS: GOODWILL TO ALL?

THE DUTY TO ACT IN GOOD FAITH AND WHAT IT MEANS TO ACT REASONABLY

The English courts have historically shown hostility towards the doctrine of good faith in English contract law. It is generally understood that there is no legal principle of good faith in dealings between commercial contractual parties. This is in contrast to many civil law systems, in which there may be an overriding principle that parties must act in good faith in the negotiation of and the performance of contractual obligations. Increasingly, parties are incorporating express terms that each party must act in good faith, but where no such term has been agreed, there is now a question whether a party must discharge his contractual obligations in good faith. We consider this issue together with the concept of what it means to act “reasonably” in this short Christmas Briefing.

Good faith, honesty

There are three principal objections to a duty of good faith under English law. First, English law proceeds incrementally and gives particular

solutions to particular problems, rather than enforcing broad, overarching principles. Second, it gives the parties freedom to contract on their own specific terms, with their own self-interest at heart in both negotiations and performance of the contract, so long as no terms are broken. Third, to imply a duty of good faith would be to create uncertainty where the parties have expressly agreed their respective obligations under a particular contract.

The exception is that duties of good faith are owed in “*relational contracts*”, where there is a fiduciary relationship, such as in partnership, agency, employment or insurance contracts.

In *Yam Seng*¹, a decision of the English High Court in February 2013, Leggatt J gave consideration as to whether good faith could as a general rule be implied into commercial contracts. Whilst his comments were *obiter* and are not binding, Leggatt J considered that failure to recognise good faith would be “swimming against the tide”² given that the principle is well-established in other jurisdictions, including most

1 *Yam Seng Pte Limited v International Trade Corporation* [2013] EWHC 111 [QB]
2 *Ibid* at [125]



civil law systems and some common law systems (e.g. in the USA³ and in Australia). The concept has also already entered the English law through EU legislation⁴.

In particular, Leggatt J preferred to imply such a duty into “any ordinary commercial contract” by use of the established methodology for the implication of terms: what would the contract, read as a whole against the relevant background, reasonably be understood to mean?⁵ It was also his view that the “relevant background” includes shared values and norms of behaviour. Such shared values and norms include honesty such that “parties entering into a commercial contract... will assume the honesty and good faith of the other”⁷.

The judge noted that the requirement of honesty meets the traditional test for the implication of a term in that it is so obvious that it goes without saying and it is necessary to give business efficacy to the contract⁸.

Leggatt J said that the obligation extended to “other standards of commercial dealing which are so generally accepted that the contracting parties could reasonably be understood to take them as read without explicitly stating them in their contractual document”⁹. This includes not engaging in conduct that is improper, commercially unacceptable, or unconscionable.

Several examples of this were given:

1. Fidelity to the parties’ bargain.
2. Co-operation.
3. No arbitrary exercise of contractual discretion.
4. Consent must not be unreasonably withheld.
5. Onerous or unusual contract terms must be brought to the attention of the other party.

When considering whether conduct is commercially unacceptable, the court is interested in the presumed intent of the parties. This is ascertained by the purposes and values of reasonable and honest people in the parties’ shoes.

Whilst *Yam Seng* has received criticism from legal commentators¹⁰ and has been said to be a case special to its context, *Yam Seng* has also received judicial attention in recent decisions.

In *Mid Essex v Compass*¹¹, the Court of Appeal restated the orthodox view that whilst English law will respect and enforce an express obligation to act in good faith, it will do this restrictively, looking to the context of the particular contract as a whole and will not imply a general duty of good faith. Further, Jackson LJ set out in his judgment that there is no general doctrine of good faith, albeit a duty of good faith may be implied by law into certain categories of contract: “if the parties wish to impose such a duty they must do so expressly”¹². As *Yam Seng* dealt

with an implied obligation of good faith (rather than an express obligation as in *Mid Essex*), there was no express disapproval of Leggatt J’s judgment.

This summer, in *Bristol Groundschool*¹³, the High Court considered whether there was an implied duty of good faith in a “relational” contract, where one party had behaved in a commercially unacceptable manner by accessing the other party’s computer and downloading information. Spearman J’s judgment is supportive of *Yam Seng*:

“Although the Court of Appeal in the *Mid Essex* case made only passing reference to the judgment of Leggatt J in the *YSP* case, and, moreover, did not focus on the implication of the duty of good faith in contracts outside the categories mentioned by Leggatt J, I detect no element of disapproval of that judgment in the judgments of the Court of Appeal. Moreover, I respectfully agree with Leggatt J’s analysis”¹⁴.

Spearman J’s ruling is the latest decision on the implication of a duty of good faith, albeit once again *obiter*. The judge placed trust at the heart of any commercial relationship so, subject to the context, an implied term as to trust may be read into the contract. Echoing Leggatt J, the judge considered that breach of an implied good faith term was to “strike at the heart of the trust which is vital to any long-term commercial relationship”¹⁵.

3 See the Uniform Commercial Code #1-203 “every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement”.

4 Industry by way of The Unfair Terms in Consumer Contracts Regulations SI 1999/2083

5 *Attorney General for Belize v Belize Telecom Ltd* [2009] 1 WLR 1988 at [1993–5]

6 *Yam Seng Pte Limited v International Trade Corporation* [2013] EWHC 111 [QB] at [135]

7 *Ibid* at [136]

8 *Ibid* at [138]

9 *Ibid* at [139]

10 Including the authors of Chitty on Contracts, 31st ed., para. 1-051

11 *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200

12 *Ibid* at [105]

13 *Bristol Groundschool Limited v Intelligent Data Capture Limited and others* [2014] EWHC 2145 (Ch)

14 *Ibid* at [196(ii)]

15 *Ibid* at [172]



It does not appear that we have yet reached the position where good faith is a duty implied in all commercial contracts. However, the courts are prepared to imply such a duty where it is possible to do so based upon the presumed intention of the parties. The position is still uncertain, and it remains questionable whether a party to an ordinary commercial contract will be able to sue for damages for breach of an implied duty of good faith where no express duty is present in the contract.

Although the extent to which “good faith” can be implied into commercial contracts is ambiguous, the test for good faith appears well established. In *Mid Essex*, Beatson LJ applied an objective test to determine the existence of a duty of good faith in the contract, which he articulated as: “when given the wording of the contract and the general context, would the conduct of the parties be regarded as commercially unacceptable by reasonable and honest people?”¹⁶. This approach mirrors that of Leggatt J in *Yam Seng* and Spearman J in *Bristol Groundschool*¹⁸.

Reasonableness

But, what of acting reasonably?

In *Yam Seng*, Leggatt J described the act of unreasonably withholding consent as an example of improper, commercially unacceptable, or unconscionable behaviour. Parties will often see express terms in their contracts by which Party A will request

something of Party B, and Party B agrees that such consent or approval will not be unreasonably withheld. Party A will want to know what remedy is available to him in the circumstances that Party B refuses.

It is settled law that where a contract allocates only to one party a power to make decisions under the contract which may have an effect on both parties, the decision maker’s discretion will generally be limited as a matter of implication. Such discretion must be exercised honestly, in good faith, and for the purpose for which it was conferred. It must not be exercised arbitrarily, capriciously or unreasonably.

This summer, the Court of Appeal handed down a decision on this point in *THE FALKONERA*¹⁹. In this case, the Court of Appeal upheld the decision of the High Court that the shipowner had unreasonably withheld its approval of the nominated vessels, where the charterer of a very large crude carrier (VLCC) had nominated two other VLCCs to receive cargoes of oil by way of ship-to-ship transfers.

In reaching this decision, Clarke LJ focussed on whether a reasonable man in the circumstances would come to the same decision as the owner, despite the fact some men might take a different view or that the decision was incorrect. He also reiterated the established position that the burden of proof rests with the party attempting to show that consent was unreasonably withheld²⁰.

The Court also approved the reasoning of Hamblen J in *Porton Capital Technology Funds v 3M UK Holdings Ltd*²¹, a key case on the issue. The relevant principles are as follows (where Party A is the requesting party, and Party B the decision making party):

1. The burden is on Party A to show that Party B’s refusal to consent is unreasonable.
2. What is reasonable depends on the circumstances of each case.
3. It is not for Party B to show that their refusal of consent was right or justified, simply that it is reasonable in the circumstances.
4. In demonstrating what is reasonable, Party B is entitled to have regard to its own interests.
5. Party B is not required to balance its own interests with those of Party A²².

Points 4 and 5 distinguish the position in commercial contracts (in contrast to the landlord and tenant cases from which the principles are derived) and clarify the extent of “reasonableness”. It is clear that neither the concept of good faith²³ nor that of reasonableness in commercial contracts requires the party with discretion to give preference to the financial interests of the other party, instead these principles have been developed to ensure that both parties enjoy the fruits of the contract.

¹⁶ *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* at [150]

¹⁷ *Yam Seng Pte Limited v International Trade Corporation* [2013] EWHC 111 [QB] at [141], [144] and [147]

¹⁸ *Bristol Groundschool Limited v Intelligent Data Capture Limited and others* [2014] EWHC 2145 (Ch) at [196(v)]

¹⁹ *Falkonera Shipping Co v Arcadia Energy Pte Ltd (the FALKONERA)* [2014] 2 Lloyd’s Rep. 406.

²⁰ *Ibid* at [85]

²¹ [2011] EWHC 2895 (Comm).

²² *Ibid* at [223]

²³ *Gold Group Properties Ltd v BDW Trading Ltd* [2010] EWHC 1632 (TCC)



Where next?

The most appropriate way of avoiding dispute in these circumstances, is to define in the contract the circumstances in which consent may or may not be refused, together with any conditions which need to be met before consent is given.

In light of the possible development as to the implication of a duty of good faith in English contract law, there may be a question of whether a party has acted in good faith when refusing consent. For the time being this will be an area open to question, but we expect further development after the decisions in *Yam Seng*, and *Bristol Groundschool*.

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