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ENGLISH CONTRACT LAW FOR SPANISH LAWYERS GOOD FAITH IN ENGLISH LAW GOVERNED CONTRACTS

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Derecho Inglés de los Contratos para Abogados Españoles – Artículo Dos – La buena fe en los contratos sujetos a ley inglesa

Presentamos el segundo artículo, de una serie de tres, que pretenden ser una aproximación a los principios generales del derecho inglés de los contratos y a su relevancia en el marco de operaciones societarias, mercantiles y financieras en el mercado español e internacional. Este artículo explora la notable ausencia de un principio general de buena fe bajo la ley inglesa de los contratos y el impacto de esta ausencia para la redacción e interpretación de los contratos sujetos a ley inglesa.

Palabras clave:
Buena fe, Derecho inglés.

English Contract Law for Spanish Lawyers – Article Two – Good faith in English law governed contracts

The second in a series of three Articles that will seek to provide an introduction to certain key principles of English contract law and its relevance in the context of Spanish/international corporate, commercial and financial transactions. The Article explores the notable absence of any general doctrine of good faith under English contract law and the impact of this absence on the drafting and interpretation of contracts governed by English law.

Keywords:
Good faith, English law.

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1. Introduction

This is the second in a series of three articles relating to interpretation of contracts under English law. In this **second article** we cover the notable absence of any general doctrine of good faith under English contract law and the impact of this absence on the drafting and interpretation of contracts governed by English law.

Unlike the position in Spain and in many other civil law jurisdictions, there is no general doctrine or principle of good faith by reference to which the English Courts interpret the provisions of English law governed contracts. This means that when an English Court comes to look at how disputed contractual provisions should be interpreted, the Court cannot and will not consider these provisions against the backdrop that both parties are subject to an overriding general principle to act and conduct themselves in good faith.

In fact, the English Courts have consistently rejected any departure from the fundamental principle that no general implied doctrine of good faith exists in English law as a tool for interpretation of contracts, and instead have developed limited "*piecemeal solutions in response to demonstrated problems of unfairness*" (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433 at 439) via, for example, equitable doctrines, legislative solutions and the common law.

However, the parties to an agreement governed by English law may themselves agree an express term in their contract to act "in good faith". Because "good faith" has no defined meaning, as it does in Spain, such an agreement then raises the question as to what, if any, is the precise content of that obligation and how, if at all, such an obligation may be enforced by the English Courts.

2. Express good faith obligations agreed by the parties to a contract

In the case of express good faith obligations agreed by the parties in a contract, the key questions will be whether, according to English Contract law and the usual rules of contractual interpretation, it is ascertainable what obligations the parties have undertaken to be performed in good faith and whether it can be verified whether a party has completed these obligations or not.

What this means in practice is that where the parties to a contract expressly provide for a duty to act in good faith, the Courts will give effect to the parties' intentions in so far as it is possible to ascertain what acting in good faith means.

2.1. What might "good faith" mean in English law?

What good faith means in the limited circumstances in which it applies in an English law governed contract will depend on the context in which it is used - i.e., primarily on what the parties have agreed in the contract in question, and on the facts of the case. The starting position is that, at present, no firm conclusions may be drawn - the question remains pending a decision from the Supreme Court. That said, in recent years the lower English Courts have sought to explore what meaning may be ascribed to express duties of good faith agreed in English contracts, and have held, for example, that duties of good faith may:

- prevent one party from taking an action that frustrates the overall purpose of the agreement / other party's reasonable expectations (*Berkeley Community Villages Ltd v Pullen* [2007] EWHC 1330);
- prohibit knowingly lulling the other party into a false belief (*Costain Ltd v Tarmac Holdings Ltd* [2017] EWHC 319);
- prohibit knowingly supplying untrue information on which the other party will rely (*Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111);
- prohibit improperly accessing the other party's computer systems (*Bristol Groundschool Ltd v Intelligent Data Capture Ltd* [2014] EWHC 2145);
- prohibit negotiating behind the other party's back (*Al Nehayan v Kent* [2018] EWHC 333); and
- require the disclosure to the other party of all material facts (*Horn v Commercial Acceptances* [2011] EWHC 1757).

The English Courts have also held that a duty of "good faith" would not:

i. override other contractual rights i.e., prevent a party from exercising a clear express contractual right to which it is entitled, or absolve the other party from its obligation to perform the same (*TSG Building Services Plc v South East Anglia Housing Ltd* [2013] EWHC 1151); or

ii. require a party to give up its commercial interests - *"[a] party subject to a good faith clause is not required to subordinate its own interests so long as the pursuit of those interests does not entail unreasonable interference in the enjoyment of a benefit conferred by express contractual terms so that such enjoyment is rendered worthless or nugatory"* (*Overlook v Foxtel* [2002] NSWSC 17; *Qatari Díar* [2010] EWHC (Ch) 1535 [240]).

Readers should note that the above-mentioned cases turn individually on their facts and, pending Supreme Court guidance, must not be taken to be of general application - rather, they are case by case examples of how an English High Court might approach the content of an express contractual obligation to act in good faith. The conclusion here is that, pending a finding from the Supreme Court on this issue, any party wishing to include such provisions in their contract should draft with extreme caution or accept at the outset that their good faith obligation may be more presentation than a concrete, legally binding obligation between contracting parties.

2.2. Express good faith obligations in an English law contract

Thus, Spanish lawyers should remain wary; the mere fact that a good faith clause (or similar) exists in the contract does not mean that the English Courts will construe the clause as imposing upon the parties a general duty of good faith. This restrictive approach is demonstrated by the Court of Appeal's decision in the *Medirest* case ([2013] EWCA Civ 200 at [106] – [107]). In *Medirest*, the clause in question provided that the parties would "*co-operate with each other in good faith and will take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable [one party] or, as the case may be, [the other party] to derive the full benefit of the Contract*". The Court of Appeal refused to accept that the clause provided for a general duty to act in good faith, holding instead that the obligation was confined to the specific circumstances contemplated by the clause:

"*The [contractual] obligation to co-operate in good faith is not a general one which qualifies or reinforces all of the obligations on the parties in all situations where they interact. The obligation to cooperate in good faith is specifically focused upon the two purposes stated in the second half of that sentence.*

Those purposes are:

i. *the efficient transmission of information and instructions; and*

ii. *enabling the [parties] to derive the full benefit of the contract.*"

Accordingly, the Court of Appeal was in a position to ascertain whether or not those obligations had been fulfilled or breached and therefore whether or not the obligation had been complied with.

Thus, whether or not an express contractual term to undertake certain actions or obligations in good faith in an English law governed contract will be enforceable will depend entirely on whether or not a court can easily ascertain what precise obligations the parties had in mind to be covered by such an express clause. The approach of the English Courts towards such clauses will therefore be restrictive as opposed to expansive.

3. Existence of a duty to negotiate in good faith in English law?

Independent of the issue of an express term to act in good faith is the long-standing principle of English law that there is no general duty to conduct negotiations in good faith. The reason for this is that, without further contractual definition by the parties, it is extremely difficult for a Court or party to be able to ascertain and verify what "negotiating in good faith" actually means and, crucially, to ascertain whether a party has fulfilled or breached such an obligation. One party's good faith negotiation may be another's bad faith or unacceptable negotiating tactic.

Accordingly, the English courts have long held that no such general principle exists, and that such a duty will generally lack sufficient certainty to be enforceable, and is fundamentally incompatible with the English law principle that each party should be free to pursue its own commercial interests in negotiations. In *Walford v Miles*[1], the House of Lords (the precursor to the English Supreme Court) explained that:

"*the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. (...) A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies.*"

Thus, a general contractual agreement to negotiate and agree in good faith will not be enforceable by the English Courts.

A further question then arises as to what amounts to a sufficiently certain "specific" duty to negotiate in good faith that could be enforceable. This issue was discussed in the case of *Petromec Inc v Petroleo Brasileiro SA*[2], where the Court of Appeal held that an express contractual provision to negotiate in good faith could be enforceable provided that it is (i) expressly set out in the agreement, (ii) part of a binding legal agreement, and (iii) drawn by reference to sufficiently concrete and certain parameters/criteria so as to be capable of being evaluated objectively by a third party, such as a Court being capable of evaluating the good faith obligation at a later stage.

In *Petromec*, the parties had agreed an express contractual provision obliging them to negotiate in good faith one of the party's "reasonable extra costs" in upgrading an oil platform. The Court of Appeal found that it was feasible to ascertain the reasonable costs of the upgrade and, consequently, the losses that would arise as a result of a failure to negotiate the upgrade in good faith. In the absence of the usual uncertainty as to the exact meaning and parameters as to what would constitute "good faith negotiations" and the consequences of not fulfilling the same, and given that the Court was able to evaluate objectively if such negotiations had occurred, the Court held it could enforce such an express clause.

The limits of the decision in *Petromec* have been considered and further defined in subsequent cases in lower English Courts, which have, on occasion, come to different conclusions as regards whether or not a *Petromec* type obligation could be enforceable. However, a definitive finding from the Supreme Court has yet to be handed down in this area. As such, the prevailing view remains that the *Petromec* decision does not represent an exception or even a shift away from the traditional English law position as set out in *Walford v Miles*. Rather, in so far as the *Petromec* test permitted the content of the obligation to negotiate in good faith to be fully verified, the two cases are entirely consistent.

4. Obligations of good faith implied by the English Courts

4.1. No general implied duty of good faith in English law

A further issue of recent significant debate is whether the English Courts can or would ever imply a specific duty to act in good faith into a contract in order to give effect to other implied duties of a fundamental nature (e.g., to act honestly). Given the English law restrictive position on express contractual provisions pertaining to good faith, it is to be expected that the Courts would be extremely reticent to potentially look beyond the terms of the parties' agreement and find a duty to act in a certain way that is not contained therein.

Whilst there has been one lower court case (*Yam Seng* [2013] EWHC 111 (QB)) that permitted such an implied finding of a duty of good faith[3] and which was initially followed by some lower courts, this case was received rather controversially and should not be viewed as breaking new ground in this area. Rather, the same and worse issues of uncertainty that plague an express obligation to negotiate in good faith are likely to be found in relation to any such implied terms, which are by their very implied nature more difficult to ascertain in terms of content. Indeed, such a position reflects the current status of English law as set out by *Medirest* where the Court of Appeal confirmed that:

"*...I start by reminding myself that there is no general doctrine of "good faith" in English contract law (...) If the parties wish to impose such a duty they must do so expressly*."[4]

A fortiori, there is therefore currently no accepted general implied duty of good faith in English law.

The Court of Appeal in the later case of *MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt*[5] also determined not to follow the *Yam Seng* approach and made strong pronouncements on the lack of a general organising principle of good faith in English law. In his Court of Appeal judgment, Moore-Bick LJ noted that the *"recognition of a general duty of good faith would be a significant step in the development of our law of contract with potentially far-reaching consequences"* and that, in his view, *"the better course is for the law to develop along established lines"* rather than to encourage judges to look for what he called *"some general organising principle"* drawn from cases of disparate kinds. He concluded that there is *"a real danger that if a general principle of good faith were established it would be invoked as often to undermine as to support the terms in which the parties have reached agreement"*.

MSC Mediterranean Shipping Company has therefore effectively curtailed the line of authority that began with the decision in *Yam Seng* and therefore reflects the current state of this issue in English law.

5. Statutory duties of good faith

In certain specific and limited contexts, duties of good faith may be imposed on the parties to a contract, or with respect to the interpretation of contractual terms, by English law statutes or by specific historic rules of caselaw. A full analysis of all such contexts is beyond the scope of this Article, but for reference important examples include:

i. **commercial agency**: in an agency relationship regulated by the Commercial Agents (Council Directive) Regulations 1993, a commercial agent has an obligation to "*look after the interests of the principal and act dutifully and in good faith*"[6] (held to mean, in this context, "*fair and open dealing*");

ii. **employment**: every English law governed contract of employment contains an implied term that the employee will serve their employer with good faith and fidelity during their employment[7] - this duty has been developed by caselaw to include such matters as, for example, duties not to compete with the employer, not to solicit the employer's customers or employees, and certain duties of confidentiality. Similarly, caselaw has made it clear that an employer must exercise any discretion it has under an employment contract (for example, a decision regarding the award of a bonus or the grant of share options) honestly and in good faith;

iii. **consumer contracts**: in a consumer contract regulated by the Consumer Rights Act 2015, terms will not be binding *vis-a-vis* the consumer if they are deemed to be "unfair", defined as "*contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer*"[8]; and

iv. **insurance**: insurance contracts governed by English law are based on the legal principle of *uberrimae fides*, imposing a duty to act "*in the utmost good faith*" on the parties thereto. The precise application of this duty will depend on the circumstances (in particular, whether the insured is a business or consumer), but generally relate to the insured party's duty to disclose material information and circumstances to the insurer so as to enable a fair assessment of risk, not present misleading information, etc.

6. Agreements to agree

As discussed in Section 3 above, an "agreement to agree", including an agreement to negotiate "in good faith", will normally be regarded by the English Courts as too vague to be legally effective and therefore unenforceable. The English Courts will not take upon themselves the role of working out, and then enforcing, what the parties might have agreed where that is not evidently clear from the terms of the contract.

For example, in an English law governed agreement an exclusivity undertaking given by one party to the contract will not be considered as an obligation to negotiate exclusively with the other party. Although the contract may say this, such a clause would, on its own, not be enforceable. Rather,

it would be considered as an obligation not to negotiate with any third party for a given period; based on English law principles, only a negative obligation not to negotiate with other parties would be enforceable.

7. Conclusion and practical advice

Whilst there has been some interesting lower Court case law developing in the area of good faith in English law, at present, Spanish lawyers should be extremely cautious about how they approach questions of good faith under English law contracts. Indeed, we expect that the fundamental issue of contractual uncertainty in ascertaining what such a good faith obligation can mean and how it can be enforced will remain an overarching concern for English courts in the coming years. Senior members of the English judiciary have reflected this position highlighting that *"(…) the problems of diminished certainty or the amount of time that might have to be spent in some cases in resolving disputes as to the application of the good faith clause"*[9] are fundamental concerns that cannot be easily resolved.

Therefore, despite much discussion in relation to the lower Court judgments exploring the issue, the fundamental principles remain that:

i. the English Courts will not have regard to any general doctrine or principle of good faith in the interpretation of English law governed contracts; and

ii. the imposition of express good faith obligations in English law governed contracts is possible, but subject to the restrictive approach and legal tests stipulated by relevant caselaw (most notably *Medirest* and *Petromec* as described above).

As to how the position may develop in the future, as noted we await a Supreme Court decision on the topic. In the meantime, the departure of the United Kingdom from the European Union will not have any immediate impact on the development of duties of good faith under English contract law; indeed, it may be that political separation and the accompanying desire to promote British sovereignty reduces the likelihood that the English common law will move closer to the civil law systems in this regard.

Considering the above, Spanish lawyers should note the following:

i. **You cannot rely on good faith terms when drafting/negotiating English law contracts** as it has largely been rejected as a principle by English law, and is considered to be too uncertain.

ii. **"Agreements to agree" between contracting parties are unenforceable** and should similarly not be relied upon. Unless drafted with sufficiently precise detail such that there is no doubt what the obligations entail and when the parties will have done enough to have discharged them, an "agreement to agree" will not be enforceable.

iii. Notwithstanding the above, elements of good faith can sometimes be successfully incorporated into English law governed documents following the three step test set out in the *Petromec* case. However, care must be taken when drafting such provisions to ensure that the obligation in question is formulated to be an express obligation, within a binding legal agreement and which, crucially, references sufficiently concrete parameters/criteria to allow objective evaluation by a third party.

Notas al final

1 [1992] 2 AC 128
2 [2005] EWCA Civ 891
3 In *Yam Seng,* Leggatt J. in the High Court held that a duty of good faith could be implied into a commercial contract
4 [2013] EWCA Civ 200 [105]
5 [2016] EWCA Civ 789
6 Regulation 3(1) of the Commercial Agents (Council Directive) Regulations 1993
7 *Faccenda Chicken Limited v Fowler* [1986] 3 WLR 288
8 Section 62(4) of the Consumer Rights Act 2015
9 "Coming to Terms with Good Faith" (Lecture at the Singapore Academy of Law, 26 April 2013) Lady Justice Arden