Publications

"Soft Obligations" in Construction Law: Duties of good faith and co-operation

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Introduction

1. Generally and traditionally concepts of good faith have no place in English contract law.
2. The reluctance of the English Courts to entertain such notions rests on two principal factors. Firstly, the introduction of such a concept is apparently irreconcilable with freedom of contract: once the parties have agreed the terms of their bargain there is no necessity to imply such a term. Secondly, a duty of "good faith" is vague and not easily capable of definition.
3. Nonetheless, there are particular types of contract which are subject to such a duty and, from time to time, the Courts have, at least, entertained submissions about the more general application of such concepts. This has in turn generated considerable academic debate on the issue.
4. It is arguable that some duty (or perhaps duties) of "good faith" have found their way into construction contracts, albeit not recognised as such. Further, the emergence of partnering and "pain/gain sharing agreement suggests that "good faith" may play a more prominent role in the future – but quite how remains unclear.

"Soft Obligations" and English Contract

The general and the specific

5. The general position is that contracts are not subject to and do not have implied into them some general duty of good faith:
    1. 5.1 In ***Interfoto Picture Library v. Stiletto*** [1989] 1 QB 433, Bingham LJ described good faith as a principle of fair and open dealing and an overriding principle existing in other legal systems but:

       "English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness. Many examples could be given. Thus, equity has intervened to strike down unconscionable bargains. Parliament has stepped in to regulate the imposition of exemption clauses and the form of certain hire purchase agreements. The common law has also made its contribution, by holding that certain classes of contract require the utmost good faith, …."
    2. 5.2 In ***First Energy (UK) Ltd. v. Hungarian International Bank Ltd.*** [1993] 2 Ll.R. 194, Steyn LJ put it this way:

       "A theme that runs through our law of contract is that the reasonable expectations of honest men must be protected. It is not a rule or principle of law. It is the objective which has been and still is the principal moulding force of our law of contract; it affords no licence to a judge to depart from binding precedent. On the other hand, if the prima facie solution to a problem runs counter to the reasonable expectations of honest men, this criterion sometimes requires a rigorous re-examination of the problem to ascertain whether the law does indeed compel demonstrable unfairness."
6. As the citation from Interfoto expressly recognises, "good faith" is not a concept unknown to English law. An obvious example is contracts of insurance which are subject to a duty of the utmost good faith. Indeed, the topic merits an entire chapter of MacGillivray on Insurance Law, 10th ed., where the principle is said to be founded on the fact that a contract of insurance is a contract of speculation. What is clear is that the meaning and effect of the duty has been well-established over a period of more than 200 years and even enshrined in statute. As

MacGillivray says at para. 17-2: "In the pre-formation period the principle of utmost good faith creates well-established duties owed by the assured and by his agent effecting the insurance to disclose material facts and to refrain from making untrue statements when negotiating the contract."

It all depends what you mean .....

7. The American position is different. Section 1-203 of the Uniform Commercial Code states that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement". A similar statement appears in the 2nd Restatement of the Law on Contract and the Comment to the Restatement provides:

   "... A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognised in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, wilful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to co-operate in the other party's performance."

8. Some of this will sound very familiar. Building contracts will commonly include express or implied terms which reflect (and provide remedies for) many of these examples of "bad faith". It is just that we call these obligations something different and we get them into contracts in a different way.
   Some examples

9. Examples of these kinds of duties or overriding principles, in fact, abound in construction contracts:
   - The Contract Administrator's duty to act fairly between the parties in the exercise of a certifying function.
   - The duty to "co-operate" and not to hinder or prevent the carrying out and completion of the works.
   - A liquidated damages clause must contain a genuine pre-estimate of loss. Otherwise it will be struck down as a penalty.
   - A contract entered into under "economic duress" may be unenforceable.

A move towards a more general principle?

10. At one time, it seemed from a trilogy of cases in the Court of Appeal that there might be a move towards a more general principle:

    1. ***Philips Electronic Grand Public SA v. BSB*** [1995] EMLR 472.

       Philips and BSB entered into a contract under which Philips were to manufacture receivers which would be able to decode BSB's satellite TV signals. Philips were obliged to maintain a manufacturing capacity. BSB's competitor, Sky, had already launched a rival service; Sky "won"; and Sky and BSB merged. This left Philips with unsold stock, unneeded manufacturing capacity and no market for the receivers. Philips argued for a series of implied terms, eg. that BSB would do nothing to frustrate the commercial purpose of the contract; that BSB would not do anything that would put an end to or change the circumstances of the contract; etc.

       The Court of Appeal rejected all of the implied terms but Sir Thomas Bingham MR added that:

       "For the avoidance of doubt we would add that we would, were it material, imply a term that BSB should act with good faith in the performance of this Contract. But it is not material."

    2. ***In Balfour Beatty v. DLR*** [1996] 78 BLR 42, the contract was based on the ICE Conditions, 5th ed., but (i) the Employer's Representative replaced the Engineer and (ii) clause 66 (and thus the arbitration clause) was deleted. In the days when Crouch was still apparently good law, this had the effect that the Contractor had no means to challenge any decision of the Employer and his representative. The Employer accepted that he was bound to act honestly, fairly and reasonably, although no such obligations were expressed in the contract.

       This time, Sir Thomas Bingham MR, stated that, had that concession not been made, the Court "would then have wished to consider whether an employer, invested (albeit by contract) with the power to rule on his own and a contractor's rights and obligations, was not subject to a duty of good faith substantially more demanding than that customarily recognised in English contract law."

    3. ***Timeload Ltd. v. British Telecom*** [1995] EMLR 459

       Timeload obtained from BT the number 0800 192 192 in order to operate a directory enquiries service. When BT realised what number they had given, they exercised a contractual right to terminate the service on notice. The relevant contractual clause was not a "for cause" provision.

       Timeload obtained an interlocutory injunction against BT; BT appealed. The Court of Appeal (in a judgment of Sir Thomas Bingham MR again) agreed with the Judge below that it was arguable that, despite the wording of the clause, BT could only terminate for cause:

       "It is therefore correct, speaking very generally, to regard BT as a privatised company, no longer a monopoly, but still a very dominant supplier closely regulated to ensure that it operates in the interest of

the public and not simply in the interest of its shareholders should those be in conflict. Against that background, I am for my part by no means sure that the classical approach to the implication of terms is appropriate here. … pure necessity is not the only ground on which a term can be implied and I can see strong grounds for the view that in the circumstances of this contract BT should not be permitted to exercise a potentially drastic power of termination without demonstrable reason or cause for doing so."

11. Any thought that these pronouncements might have some impact on building contracts would be misconceived. A series of recent decisions demonstrates that the TCC and Mercantile Courts are adhering to the traditional approach and on traditional grounds:

    1. ***Bedfordshire County Council v. Fitzpatrick 62 Con LR 64*** [TCC]

       The Council and Fitzpatrick entered into a Highways maintenance contract. There were a number of contentious issues between the parties, such that when instructed to start work under the contract, Fitzpatrick asked for a later start date. The Council purported to treat this as a repudiatory breach and terminated the contract.

       At trial, counsel for the Council argued that there was an implied term of the contract, analogous to the duty not to destroy the relationship of "confidence and trust" in an employment contract. He relied, inter alia, on the fact that the contract was for the provision of a continuous maintenance service rather than a single project.

       Dyson J. declined to imply such a term. He did so on the grounds that the term did not satisfy the test of necessity and was "couched in rather general terms" and in "broad and imprecise language". There was, he said, no greater need for trust and confidence in a continuous maintenance contract than in a lengthy single project contract.

    2. ***Francois Abballe (t/a GFA) v. Alstom UK Ltd.*** LTL 7.8.00 [TCC]

       The parties entered into a Joint Venture Agreement for the potential construction of a power station. The JVA contemplated a further agreement under which they would proceed to build the power station. A clause of the JVA entitled either party to withdraw from the JVA if they were of the opinion that the project was not economically viable. Alstom withdrew in reliance on this clause. GFA contended that this was not the real reason for their withdrawal. On an application to strike out, the Court found in favour of Alstom. GFA then applied to amend to plead, inter alia, a claim based on an implied term of good faith.

       His Honour Judge Lloyd Q.C. refused to imply such a term:

       "It is evidently devised to deal with the merits as they are perceived by the Claimant. The proposition that "good faith" may be used as a fall-back device tellingly shows why it is wrong but tempting to consider with the advantage of hindsight whether a term should be implied. At the date of this agreement it was not necessary to imply the term suggested for in my view the contract is effective without it. .."

       The Judge quoted Lord Steyn's paper "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" as follows:

       "But I have no heroic suggestion for the introduction of a general duty of good faith in our contract law. It is not necessary. As long as our courts always respect the reasonable expectations of parties our contract law can satisfactorily be left to develop in accordance with its own pragmatic traditions. And where in specific contexts duties of good faith are imposed on parties our legal system can readily accommodate such a well-tried notion. After all, there is not a world of difference between the objective requirement of good faith and the reasonable expectations of the parties."

       "This is not a case in which an express obligation of good faith exists. … If Lord Steyn does not see the necessity for such a general obligation I do not consider that I should be a hero and permit the claimant to advance a term which is in effect such a general duty expressed within the contract of this contract."

    3. ***Hadley Design Associates v. Lord Mayor and Citizens of the City of Westminster*** [2003] EWHC 1617 [TCC]

       This case concerned a contract for professional services over a long period which was terminated by Westminster on notice. HDA argued for the implication of a series of implied terms limiting the circumstances in which Westminster could terminate. They relied expressly on Timeload.

       Pointing out both that the Court of Appeal in Timeload had decided only that the matter was arguable and that that had turned on the particular position of BT, His Honour Judge Seymour QC rejected these arguments. Counsel further argued that English law was developing in the direction of implying a duty of good faith. The Judge rejected that argument and at para. 89 concluded:

       "The development of the law in the direction anticipated by Sir Thomas Bingham … would, it seems to me, be fraught with difficulty: it would seem to involve, first, the identification of a principle of the common law, the existence of which was hitherto unsuspected, on the basis of which the court could invalidate, or

restrict the operation of, a provision in a contract. Whatever this principle was found to be, it would, or might apparently only operate in situations of a very special kind, seemingly where a dominant supplier of a service had entered into a contract to provide that service. What might be the defining characteristics of situations in which the principle would be applicable is, for the moment, unclear. … I should not be prepared to venture into these treacherous waters without the benefit of extremely full consideration of relevant authorities from all jurisdictions in which these issues have been examined. In the absence of citation of relevant authority I am not satisfied that the principle for which Mr Burr contends exists in English law."

So, again, the very lack of certainty in such obligations was fatal.

4. ***Ultraframe (UK) Ltd. v. Tailored Roofing Systems Ltd.*** [2004] 1 Ll.R. 341 [CA; Mercantile Court]

   Ultraframe were manufacturers of components of conservatory roofs. Tailored Roofing purchased components from them to make up into packs for sale to installers. The parties entered into a contract pursuant to which Tailored Roofing undertook to purchase all its roofing components from Ultraframe in return for a substantial discount. Ultraframe then set about poaching Tailored Roofing's clients. Tailored Roofing argued that two terms should be implied into the contract: (i) that Ultraframe should not deliberately or intentionally injure Tailored Roofing's business and (ii) that Ultraframe should act at all times in good faith towards them. The Court of Appeal declined to imply either term. Such terms were not necessary.

Express duties of good faith

12. There seems then no inclination on the part of the TCC Judges to wade heroically into treacherous waters and imply duties of good faith (as opposed to other "soft obligations") into contracts and no more enthusiasm on the part of the Court of Appeal when expressly asked to do so. The reasons given are the "traditional" ones: such a term is not necessary to give the contract business efficacy and it is vague.

13. The remarks of Lord Steyn in the paper quoted above, however, seem to contradict the latter of these two reasons describing a duty of good faith as a "well-tried notion". The problem is that it is perhaps a well-tried notion in particular contexts (such as insurance law) but not in others, including construction contracts.

14. It follows that even if the contract expressly imposes a duty of good faith, what it means is up for grabs.

15. This is part of the challenge facing "partnering" type agreements.

16. "Partnering" itself is, of course, conceptually different from the "mere" imposition of a duty of good faith. It contemplates a co-operative approach to contract management with a view to improving performance and reducing disputes . That said, partnering documents contain the language of "good faith" and pose the same problems of interpretation. For example:

    - Under the JCT Non-Binding Partnering Charter the parties agree to act in good faith; in an open and trusting manner; in a co-operative way; in a way to avoid disputes by adopting a "no blame" culture; fairly towards each other; and valuing the skills and respecting the responsibilities of each other.
    - The ACA Standard Form of Contract for Project Partnering PPC 2000, the parties agree to work together and individually in the spirit of trust, fairness and mutual co-operation (clause 1.3).

17. Although conceptually different again, "pain/gain sharing" agreements may have some relevance here. This is the type of contract where, based on a risk assessment, a target price and probably a maximum price are set with express contractual provisions for the sharing of the "gain" if the project comes in below the target price and the "pain" if it does not. The JCT Major Project Form (2003 ed.) contains particular provisions which reflect the same type of approach – clause 19 (cost savings and value improvements) encourages the contractor to suggest changes that will benefit the project and the employer; where the employer wants to implement such a change, the parties are to negotiate with a view to agreeing the contractor's quotation and the employer's benefit; and the contractor is to be paid a proportion of the financial benefit (as defined).

18. It is suggested that this is an area where the Courts might be persuaded on grounds of necessity or even a more general principle to imply a duty of good faith in the operation of such provisions and the conduct of such negotiations. But then why should they if the contract imposes no express obligation?

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