Commercial Dispute Resolution

Duties of good faith in commercial contracts

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Ben Giaretta of Mishcon de Reya considers the evolution of the concept of good faith and its future in English contract law.

Sex was invented in 1963, according to Philip Larkin. It was 50 years later in 2013 that good faith was invented in English law, according to some. That was in the case of *Yam Seng Pte Ltd v International Trade Corporation Limited*. The truth is that good faith has been part of English law for much longer than that.

As long ago as the middle of the 18th century Lord Mansfield wrote in the context of an insurance contract 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, after falling out of favour in the 19th and 20th centuries, a new focus has been turned on the duty of good faith as a result of the *Yam Seng* case. There Mr Justice Leggatt (as he then was, now **Lord Justice Leggatt**) opined that a duty of good faith might be implied into certain contracts; specifically those that he described as "relational", which require a high degree of communication, cooperation and predictable performance based on mutual trust of confidence (as in the case of some long-term joint venture agreements, for example).

Good faith, of course, has long been a feature of contract law in other countries, particularly those that have legal systems derived from Roman law. But in other common law countries as well, such as in the United States, the principle of good faith has been long established in contract law.

Perhaps under the influence of such other laws – and perhaps with an uncertain understanding of where good faith fits into English law – there was a trend even before *Yam Seng* towards parties including express duties of good faith in their English law-governed contracts. For example, in *Berkeley Community Villages Ltd v Pullen* the parties agreed to "act with the utmost good faith towards one another", which the judge interpreted as an obligation for each party to "observe reasonable commercial standards of fair dealing in accordance with their actions which related to the Agreement" and "faithfulness to the agreed common purpose and consistency with the justified expectations of [the counterparty]".

The latest word on duties of good faith in English contract law has come in 2019 in Bates v Post Office Limited, a case concerning the contract between the **Post Office** and sub-postmasters throughout the country, and the introduction of a new IT system. **Mr Justice Fraser** stated there that relational contracts containing an implied duty of good faith were now an established category in English law, and good faith involved

something more than just a requirement to act honestly. He said that it meant “parties must refrain from conduct which in the relevant context would be regarded as commercially unacceptable by reasonable and honest people”.

The duty of good faith is plainly here to stay, at least in relation to certain types of contracts. The question is what this means for contracting parties – and whether they should routinely incorporate good faith clauses into their contracts or, on the other hand, expressly exclude the duty of good faith in order to avoid the possibility of a court implying such a duty into their contracts in the future.

The risk of such clauses, of course, is that they introduce an element of unpredictability into the operation of contracts because the parties are leaving it to a judge or an arbitrator in the future to decide whether their actions have been “commercially unacceptable” by the standards of “reasonable and honest people”. The question of what may or may not be “acceptable” by those standards might imply a fair degree of discretion on the part of the judge or arbitrator, and expand the scope of rights and obligations in unforeseen ways.

On the other hand, arguably the duty of good faith offers a valuable protection which all sensible parties should welcome, while it might be said that such a duty does not add much more to the protections currently available in English contract law; rather, it gathers together under one heading a number of existing strands of English contract law, such as the implied duty to co-operate towards achieving, rather than undermine, the common purpose of a contract. And it has not been suggested in any of the case law that there is a general duty of good faith in English contract law: it is only in certain contracts that such a duty will be implied, in particular those in which (as the judge in *Bates* said) “the spirits and objectives of their venture may not be capable of being expressed exhaustively in a written contract”.

That phrase perhaps goes some way towards explaining the renewed focus on the duty of good faith. If the venture is too complex to be captured properly in a traditional contract form, how are the courts to make sense of it? The duty of good faith might be seen as a recognition of the increasing complexity of the modern world, and the difficulties that English law has in reconciling contract terms with that complexity.

Indeed, the *Bates* case might be the epitome of this. It concerned the failings of a complex computer system which resulted in sub-postmasters being penalized for accounting errors that were wrongly ascribed to them. Faced with the rigid operation of algorithms, and equally with the rigidity of contractual terms written long before the events that they are intended to regulate, English law assesses the parties' actions in implementing the contract against a touchstone of the standards of “reasonable and honest people”. As commercial activity becomes more and more complex, and in particular as computers and artificial intelligence become more and more a feature of our lives, there may be even more recourse to duties of good faith between people.

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