

# MACFARLANES

## THE LIMITS OF GOOD FAITH OBLIGATIONS

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In *Portsmouth City Council v Ensign Highways Ltd* [2015] EWHC 1969 (TCC), the High Court rejected the contention that an express duty of good faith stated in part of a contract operated across the contract as a whole. The key point arising out of this case is that, where the parties have identified specific situations in which they will be required to act in good faith, it is less likely that the Court will find that there is a general duty to perform a contract in good faith.

### UNDERSTANDING THE LIMITS TO AN IMPLIED OBLIGATION TO ACT IN GOOD FAITH

- ◆ There is no general duty of good faith in English law.
- ◆ However, an obligation to act in good faith may be implied, using the normal rules on the implication of terms in fact.
- ◆ An obligation to act in good faith is more likely to be implied in long term or “relational” contracts e.g. joint venture agreements, franchise agreements and long term distribution agreements.
- ◆ Where the parties have included express obligations to act in good faith in certain specified circumstances, it is less likely that a general obligation to act in good faith will be implied into a contract as a whole.
- ◆ An implied duty of good faith will not normally “cut across” the express provisions of a contract.
- ◆ It is less likely that an obligation to act in good faith will be implied in a contract between two sophisticated parties negotiating at arm’s length.
- ◆ Where there is an (express or implied) obligation to act in good faith the content of that obligation will depend on the circumstances of the particular case. However, in general terms, it will require the parties to avoid acting in a way which would be regarded as “commercially unacceptable” by reasonable and honest people in the particular context involved.

### THE CHALLENGE FOR CONTRACTING PARTIES

The difficulty with these principles is that they are broad and flexible in nature and each case is likely to turn on its own facts. This makes it harder to predict whether a judge will find that there is an implied obligation of good faith in any given situation. Therefore, the best approach, at least in long term or relational contracts, will be for parties to consider, and make express provision for, the circumstances in, and the extent to which, they will be required to act in good faith. By way of practical example, it may be appropriate to identify the extent to which parties should be required to provide information to one another and the extent to which they should be required to subordinate their own commercial interests to those of their contractual counterparty. As *Portsmouth City Council* shows, this will reduce the scope for argument about implied terms at a later date.

### BACKGROUND

In July 2004, Portsmouth City Council (PCC) entered into a long term PFI contract (the Agreement) with Ensign Highways Ltd (Ensign) for the maintenance of PCC’s highway network. Although the arrangement originally worked well, reductions in funding for local authorities subsequently caused PCC to take the view that it was no longer affordable.

The Agreement gave PCC the right to “award” service points to Ensign for breaches of its contractual obligations (which could, ultimately, result in PCC having the right to terminate the Agreement). PCC appears to have embarked on a strategy of awarding Ensign large amounts of service points in order to force a commercial renegotiation of the deal. Unsurprisingly, Ensign objected to this. The dispute was initially referred to expert determination in accordance with the Agreement. The expert concluded that PCC had acted in bad faith.

PCC then issued proceedings in the High Court seeking declarations in relation to the manner of its awarding of the service points. The Agreement contained reference to express duties of good faith at numerous points. In particular it contained a clause noting that PCC was subject to a requirement, imposed by section 3 of the Local Government Act 1999, to obtain “best value”. Within that clause, under the heading “Liaison and Partnering”, was an obligation on the parties to deal fairly, in good faith with each other. Ensign argued that this express obligation to act in good faith was an overriding obligation which applied to the contract as a whole or, in particular, to the award of service points.

Ensign sought to rely on the decision of Leggatt J in *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111, where an obligation to act in good faith was implied into a distribution agreement, based on the presumed intentions of the parties. A summary of Yam Seng is available [here](#).

#### THE DECISION

The judge, when considering whether PCC was under a general duty to act in good faith found that there were a number of reasons why the duty of good faith stated in the "best value" provision did not apply more widely, including that: (i) there was nothing in the wording to suggest the duty applied more generally; (ii) the fact that certain clauses referred to such a duty suggested that the parties had considered the specific situations when a duty should apply; and (iii) the Agreement did not require the implication of a duty of good faith in order to make it work.

Similarly the judge was not prepared to imply a duty of good faith in the provision regarding the manner in which service points were awarded. Instead the judge implied a term that in the awarding of service points PCC had to act honestly and on proper grounds and not in a manner that was arbitrary, irrational or capricious.

This is the latest decision in a growing line of cases concerning good faith obligations and can be an unfortunate area of exposure for contractual parties.

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