

**PINSENT MASONS LECTURE IN HONG KONG ON 22<sup>nd</sup> NOVEMBER 2017**

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**DOES GOOD FAITH HAVE ANY ROLE IN CONSTRUCTION CONTRACTS?**

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1. INTRODUCTION

1.1 Scheme of this lecture. The scheme of this lecture is first to look at the origins of ‘good faith’ in Roman law and civil law; then to examine its more limited role in common law jurisdictions; then to consider what (if anything) a contractual obligation of good faith actually means. After that, as is only fitting in Hong Kong, I shall look at the expansive role of good faith in Chinese law. Finally, I shall focus on the exiguous role of good faith in construction contracts.

1.2 Definitions. This lecture uses the following definitions:

“England” means England and Wales.

“TCC” means the Technology and Construction Court in England.

1.3 Thanks. I am grateful to Anthony Jones of 4 New Square for the considerable research which he has done to assist my preparation for this lecture. I am also grateful to Anirudh Mandagere, my judicial assistant in the Court of Appeal, for his assistance.

2. ROMAN AND CIVIL LAW

2.1 Roman law. The Romans were ahead of their time in recognising a version of contract law. The original Roman conception of a contract was little more than a debt arising from a solemn promise to pay (*stipulatio*). By the first century BC the Romans recognised bilateral contracts, i.e. arrangements under which each party owed obligations to the other. Such contracts rested on *bona fides* and were enforced by *bonae fidei* actions. Gaius said that contractual obligations arose in one of four ways, namely *re* – by transfer of a thing; *verbis* – by uttering formal words; *litteris* – by a document; *consensu* – by a consensual contract. There were only four recognised categories of contract: sale, hire, partnership and mandate.

2.2 Civil law jurisdictions. Modern civil law jurisdictions are faithful to their Roman roots. Good faith is a general obligation which forms part of every contract. French and German law are typical in this regard.

2.3 France. Article 1134 of the French Civil Code provides:

“Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites. Elles ne peuvent être révoquées que de leur consentement mutuel, ou pour les causes que la loi autorise. Elles doivent être exécutées de bonne foi.”

2.4 Germany. Article 242 of the German Civil Code provides:

“Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.”<sup>1</sup>

### 3. COMMON LAW JURISDICTIONS

3.1 The traditional approach. Common law jurisdictions recognise a duty of good faith, if the contract contains an express term to that effect. Traditionally, however, the common law has not recognised an obligation of good faith as implicit in all contracts, or even in all commercial contracts.

#### (i) England

3.2 Interfoto. In *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433 at 439 Bingham LJ famously stated:

“In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as “playing fair,” “coming clean” or “putting one’s cards face upwards on the table. ...

English law has, characteristically, committed itself to no such overriding principle [as good faith] 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, by treating as irrecoverable what purport to be agreed estimates of damage but are in truth a disguised penalty for breach, and in many other ways.”

3.3 Yam Seng. Equally famously, Leggatt J challenged the orthodox view in *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB). He argued that England was swimming against the tide of EU legislation. Regulations implementing EU directives usually imported a requirement of good faith. Some US courts had accepted that all contracts have an implied good faith obligation. Other common law jurisdictions are moving in the same direction. He concluded at [131] that:

“there seems ... to be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying [a duty of good faith] in any ordinary commercial contract based on the presumed intentions of the parties.”

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<sup>1</sup> “An obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration.”

3.4 The reaction to Yam Seng. Many commentators welcomed Leggatt J's decision.<sup>2</sup> Many judges did not. The Court of Appeal in *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* specifically rejected such a general principle. Moore-Bick LJ said at [45]:

“There is in my view 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.”<sup>3</sup>

3.5 Relational contracts. While a *general duty* has been rejected, a number of decisions from late 2015 onwards have accepted the more limited proposition that, in the particular contractual context of '*relational contracts*' (such as those involving a joint venture, franchise agreement, or long term distribution agreement), an obligation that parties act in good faith may be implied in fact. Cases supporting that limited position include:

- *Globe Motors Inc v TRW LucasVarity Electric Steering*, where Beatson LJ noted, *obiter*, that (in the context of an ongoing exclusive supply agreement) had an argument been advanced that a good faith obligation required party A to provide party B with an opportunity to demonstrate that it could provide a particular product before party A sought that product from an alternative supplier, then such implication “might have given considerable force” to the claim.<sup>4</sup>
- *National Private Air Transport Services Company (National Air Services) Ltd v Creditrade LLP and anor*, where Blair J endorsed *Yam Seng*, but decided that the instant contract (a sublease) was not apt for the implication of a duty of good faith.<sup>5</sup>
- *Property Alliance Group Ltd v The Royal Bank of Scotland plc*, in which Asplin J accepted that there are ‘recognised categories’ of contracts in which good faith may be implied, but that the instant case (involving sophisticated commercial parties and express terms excluding fiduciary obligations) did not fall within any such category.<sup>6</sup>
- *Portsmouth City Council v Ensign Highways Ltd* [2015] EWHC 1969 (TCC), in which Edwards-Stuart J held that a good faith obligation was implied into a 25-year PFI contract for the maintenance of roads. The council's statutory ‘best value’ duty and its recognition in the contract were critical to the court's decision. The judge accepted that generally “a duty of good faith is not usually implied into commercial contracts under English law”: see [81].

3.6 Contracts requiring a party to hold the balance fairly between opposing interests. Many contracts require individuals to hold the balance between competing interests: the quantity surveyor assessing interim payments, the architect or engineer issuing certificates and so forth. Sometimes it is one of the two parties with opposing interests, which is required to hold the balance. In such a case there is an implied term that the party will do so fairly: *Mid-Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* [2013] EWCA Civ 200 at [77]-[83]. That is different

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<sup>2</sup> See, for example, Jan van Dunné, ‘On a clear day you can see the Continent – the shrouded acceptance of good faith as a general rule of contract law on the British Isles’, 31 *Construction Law Journal* (2015) 3-25; Trakman & Sharma, ‘The binding force of agreements to negotiate in good faith’, 73 *Cambridge Law Journal* [2014] 598-628. For the opposite view, see Carter & Courtney, ‘Good faith in contracts: is there an implied promise to act honestly?’, 75 *Cambridge Law Journal* [2016] 608-619.

<sup>3</sup> *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* [2016] EWCA Civ 789, [45] (Moore-Bick LJ).

<sup>4</sup> *Globe Motors Inc v TRW LucasVarity Electric Steering Ltd* [2016] EWCA Civ 396, [67]-[69] (Beatson LJ).

<sup>5</sup> *National Private Air Transport Services Company (National Air Services) Ltd v Creditrade LLP and anor* [2016] EWHC 2144 (Comm), [132]-[136] (Blair J).

<sup>6</sup> *Property Alliance Group Ltd v The Royal Bank of Scotland plc* [2016] EWHC 3342 (Ch), [275]-[276] (Asplin J).

from a 'good faith' obligation. In *Portsmouth City Council* (above), the council was required to award service points for breaches by Ensign. It was implicit in the contract that the council would award service points fairly and not increase them to protect its own interests: see [90]. As I read the judgment, that was separate from the 'good faith' obligation. The contract in *Mid-Essex* provided for the employer to award service failure points for breaches, but the express provisions also specified precisely what points should be awarded for each type of breach, so there was no need for any additional implied term.

#### (ii) Australia

3.7 The general position. The Australian courts do not accept that an obligation of good faith should be implied generally into commercial or other contracts.<sup>7</sup> *Automasters Pty Ltd v Bruness Pty Ltd* [2002] WASC 286, an authority often cited in these discussions, is not really to the point. The contract in that case contained an express good faith obligation: see [139].

3.8 Special categories of contract where a duty of good faith is recognised. The Australian courts:

“have been willing to imply such a duty in contracts for joint ventures or partnerships where there is a need for a high degree of cooperation and reliance by all the parties on the good faith of each other party, particularly in the context of their working together to achieve a common objective.”<sup>8</sup>

#### (iii) Singapore

3.9 The One Suits. According to the *obiter* summary in *The One Suits Pte Ltd v Pacific Motor Credit (Pte) Ltd*, the Singapore courts evince the same general approach: namely, rejecting the suggestion that a general duty of good faith should be implied in law to commercial contracts across the board, but accepting the possibility of such implication in fact in the context of contracts which involve a high degree of reliance and partnership.<sup>9</sup>

#### (iv) Canada

3.10 *Bhasin v Hrynew.* Canada has gone further than any other common law jurisdiction in recognising a duty of good faith in commercial contracts. In *Bhasin v Hrynew* [2014] SCC 41 C employed B on a 3-year contract, which was renewable unless either party gave notice. C misled B in discussions and, unexpectedly, gave notice of non-renewal. The Canadian Supreme Court, reversing the Alberta Court of Appeal, held that C was in breach of an implied duty of good faith. Cromwell J, delivering the principal judgment, with which other members of the court agreed, said:

“[63] The first step is to recognize that there is an organizing principle of good faith that underlies and manifests itself in various more specific doctrines governing contractual performance. That organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.

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<sup>7</sup> And the High Court declined to endorse the argument in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5.

<sup>8</sup> *Insurance Commission of Western Australia v The Bell Group Ltd (in liq)* [2017] WASC 122 (Supreme Court of Western Australia), [57] (Pritchard J), citing *Tote Tasmania Pty Ltd v Garrott* (2008) 17 Tas R 320, [17] and *Alstom Ltd v Yokogawa Australia Pty Ltd (No 7)* [2012] SASC 49, [597].

<sup>9</sup> *The One Suits Pte Ltd v Pacific Motor Credit (Pte) Ltd* [2015] SGCA 21 (Singapore Court of Appeal), [44] (Menon CJ, Chao and Leong JJA).

[64] As the Court has recognized, an organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations ...

[65] The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While “appropriate regard” for the other party’s interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.

[66] This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. But we should also recognize that this list is not closed. The application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs.”

#### (v) Hong Kong

3.11 The traditional position. In *Aktieselskabet Dansk Skibsfinansering v Wheelock Marden* [1994] HKCA 384 the Court of Appeal allowed the defendants’ appeal against a finding of misrepresentation. At [61] Godfrey and Liu JJA stated:

“It must first be observed, as ADS accepts, that our law does not recognise what was described in argument as a “free-standing” duty of disclosure. In a commercial negotiation, one party may be aware of some fact which would to his knowledge materially affect the course of the negotiation if disclosed to the other. But he is not, ipso facto, obliged to disclose it.”

In support of that proposition they set out the passage from Bingham LJ’s judgment in *Interfoto* quoted in paragraph 3.2 above.

3.12 Pre-Yam Seng cases. There appear to have been two subsequent cases which address the question of implication of a contractual duty of good faith, both pre-dating *Yam Seng*. In *Hyundai Engineering and Construction Company Ltd v Vigour Ltd* (2005), Reyes J at first instance was concerned mainly with the question of a duty of good faith in pre-contractual negotiations (which was rejected), but noted in passing that a contract included ‘an implied obligation of cooperation

and good faith.<sup>10</sup> In *Hong Jing Co Ltd v Zhuhai Kwok Yuen Investment Co Ltd* (2012), the Court of Appeal held that, in the context of an exclusivity arrangement, the parties to a contract stood in a fiduciary relationship such that one party was under an implied contractual duty to ‘use its best or at least reasonable endeavours in good faith’ to reach a deal on its counterpart’s debts with third party creditors.<sup>11</sup> There is no further substantive treatment of the issue in cases post-dating the *Yam Seng* decision.

3.13 Enforcement of arbitration awards. The Hong Kong courts have for many years recognised that the good faith principle prevents a party to arbitration keeping a point about the composition of the tribunal up its sleeve, only to pull it out if the arbitration is lost: see *China Nanhai Oil v Gee Tai Holdings* [1995] 2 HKLR 215 at [225] and *Herbei Import and Export Corp v Polytech Engineering* [1999] 2 HKCFAR 111. In this context good faith comes very close to estoppel. Indeed, it is doubtful how far the good faith principle can go beyond estoppel. In *Astro Nusantara International BV v Pt Aynnda Prima* [2016] HKCA 595 the Court of Appeal said at [69]:

“We do not think it controversial it is important to have regard to the “choice of remedies” principle. We agree with Mr Landau that the principle of “good faith” and the “choice of remedies” principle are not mutually exclusive but complementary. Applying the principle of “good faith” too rigorously whenever there is a failure to pursue active remedies might bring this into conflict with the “choice of remedies” principle. The answer may be that regard should be had to the full circumstances why an active remedy is not pursued or other relevant considerations (such as whether there was a clear reservation of rights so the opposite party was not misled).”

#### 4. WHAT DOES GOOD FAITH ACTUALLY MEAN IN THE COMMON LAW CONTEXT?

4.1 Yam Seng. In *Yam Seng* suggested the following meaning at [141]-142]:

“141. What good faith requires is sensitive to context. That includes the core value of honesty. In any situation it is dishonest to deceive another person by making a statement of fact intending that other person to rely on it while knowing the statement to be untrue. Frequently, however, the requirements of honesty go further. For example, if A gives information to B knowing that B is likely to rely on the information and A believes the information to be true at the time it is given but afterwards discovers that the information was, or has since become, false, it may be dishonest for A to keep silent and not to disclose the true position to B. Another example of conduct falling short of a lie which may, depending on the context, be dishonest is deliberately avoiding giving an answer, or giving an answer which is evasive, in response to a request for information.

142. In some contractual contexts the relevant background expectations may extend further to an expectation that the parties will share information relevant to the performance of the contract such that a deliberate omission to disclose such

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<sup>10</sup> *Hyuandai Engineering and Construction Co Ltd v Vigour Ltd* [2004] HKCFI 205 (Hong Kong Court of First Instance), [99] (Reyes J).

<sup>11</sup> *Hong Jing Co Ltd v Zhuhai Kwok Yuen Investment Co Ltd* [2012] HKCA 296 (Hong Kong Court of Appeal), [37(1)] and [37(23)] (Cheung JA).

information may amount to bad faith. English law has traditionally drawn a sharp distinction between certain relationships – such as partnership, trusteeship and other fiduciary relationships – on the one hand, in which the parties owe onerous obligations of disclosure to each other, and other contractual relationships in which no duty of disclosure is supposed to operate. Arguably at least, that dichotomy is too simplistic. While it seems unlikely that any duty to disclose information in performance of the contract would be implied where the contract involves a simple exchange, many contracts do not fit this model and involve a longer term relationship between the parties which they make a substantial commitment. Such “relational” contracts, as they are sometimes called, may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties’ understanding and necessary to give business efficacy to the arrangements. Examples of such relational contracts might include some joint venture agreements, franchise agreements and long term distributorship agreements.”

4.2 Trakman and Sharma article. L. Trackman and K. Sharma, of the University of New South Wales, address the same question in their article previously cited.<sup>12</sup> They suggest that the duty of good faith requires:

- Loyalty to the contractual promise and the conduct surrounding its formation;
- Compliance with industry standards;
- Compliance with social norms, ‘such as common decency standards’.

4.3 Splendid, but does any of that hold water? Let us take the *Yam Seng* analysis first. *Yam Seng* at [141] says that the duty of good faith applies if D “deceives another person by making a statement of fact intending that other person to rely on it”. But surely the law of tort provides the remedy there? Alternatively, if the contract involves reporting of matters between the parties or sharing of information, the contractual provisions will expressly or impliedly require each party to give correct information (or at least information believed to be correct) to the other. It is submitted that an amorphous duty of “good faith” adds nothing to the duties imposed by the contract or by the law of tort.

4.4 OK, but have Trackman and Sharma cracked it? Not really, no. Loyalty to the contractual promise surely means complying with the terms of the contract? The conduct surrounding the formation of the contract is very dubious territory from which to exhume any contractual obligations. As to industry standards or social norms, these are either expressed or implied in the contract or they are not. An unparticularised obligation of good faith cannot hover over the contract and change its terms.

4.5 What about relational contracts? There is now a burgeoning literature about relational contracts. No self-respecting academic in this area can resist the temptation to write about them. One of the most influential papers is that by Professor Hugh Collins, published last year.<sup>13</sup> After

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<sup>12</sup> ‘The binding force of agreements to negotiate in good faith’, 73 *Cambridge Law Journal* [2014] 598-628 at 610-617

<sup>13</sup> ‘Is a Relational Contract a Legal Concept?’ in Degeling, Edelman and Goudkamp (eds), *Contracts in Commercial Law* (Sydney, Thompson Reuters, 2016). Hugh Collins is Vinerian Professor of English Law at Oxford and a fellow of All Souls College.

discussing *Yam Seng* and two subsequent cases,<sup>14</sup> Collins concludes that “the building blocks of a legal concept of a relational contract seem to be in place”. He identifies four features of the paradigm of a relational contract:

- (i) A long term business relationship;
- (ii) Investment of substantial resources by both parties;
- (iii) Implicit expectations of co-operation and loyalty that shape performance obligations in order to give business efficacy to the project;
- (iv) Implicit expectations of mutual trust and confidence going beyond the avoidance of dishonesty.

I accept that there are contracts of that character and I have no objection to people giving them a label if they want to. Those contracts will generally contain express or implied obligations to co-operate and no doubt a host of similar obligations. But I question whether there is any need to super-add an obligation of good faith. The general law implies a duty to co-operate.<sup>15</sup> It is difficult to see what additional conduct an obligation of good faith will import, beyond those obligations arising under the express or implied terms.

4.6 The Australian view. The Full Court of the Federal Court stated in *Marmax Investments Pty Ltd v RPR Maintenance Pty Ltd* [2015] FCAFC 127:

“[t]he implied obligation of good faith does not place contracting parties in a fiduciary relationship. That is, it does not require a contracting party to prefer the interests of the other contracting party, or to subordinate its self-interest ... In our opinion, the implied duty of good faith [in the present case] did not require anything more of [the appellant] than the duty to cooperate. [The respondent] did not suggest to the contrary.”<sup>16</sup>

That passage lets the cat out of the bag. The implied duty of good faith added nothing to the (already existing) duty to co-operate. If it added nothing, why should it be implied at all?

4.7 What about an obligation to negotiate in good faith? Here we are on firmer ground. ‘Faith’ is a state of mind. Negotiating in good faith means negotiating in a genuine attempt to reach a deal, rather than just going through the motions. In *Petromec Inc v Petroleo Brasileiro SA* [2005] EWCA Civ 891 the Court of Appeal upheld as enforceable the following contractual term:

“Brasoil agrees to negotiate in good faith with Petromec the extra costs referred to in Clause 12.1 and 12.2 above and the extra time referred to in Clause 12.2 above . . . .”

In reaching this (obviously sensible) conclusion the Court of Appeal distinguished the House of Lords’ decision in *Walford v Miles* [1992] 2 AC 128.

## 5. CHINESE LAW

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<sup>14</sup> *Bristol Groundschool Ltd v Intelligent Data Capture Ltd* [2014] EWHC 2145 (Ch) and *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB)

<sup>15</sup> *Mackay v Dick* (1881) 6 App Cas 651

<sup>16</sup> *Marmax Investments Pty Ltd v RPR Maintenance Pty Ltd* [2015] FCAFC 127 (Full Court of the Federal Court of Australia), [149]-[150] (Middleton, Foster, and Gleeson JJ).

5.1 Article 6. In contrast to the broadly similar approaches found in the common law jurisdictions, in the People’s Republic of China, good faith enjoys a central position. Article 6 of China’s Uniform Contract Law provides that, as a general principle:

“The parties shall observe the principle of good faith in exercising their rights and fulfilling their obligations.”

5.2 Negotiation and performance. At the negotiation stage, a party may be liable for loss caused for *‘engaging in consultation with malicious intention in the name of making a contract,’* or *‘concealing intentionally key facts related to the making of the contract or providing false information’* or *‘taking any other act contrary to the principle of good faith’*.<sup>17</sup> Parties to contracts in China must also, in their contractual performance, *‘observe the principle of good faith and fulfil the obligations of notification, assistance and confidentiality in accordance with the nature and aims of the contract and trade practices.’*<sup>18</sup> Further, after termination, parties are also obliged to *‘perform the duties of notification, assistance and confidentiality in light of the principles of good faith and in accordance with trade practices.’*<sup>19</sup> In addition, *‘good faith’* is listed as one of the guides to contractual interpretation.<sup>20</sup>

5.3 Application of the principle. Despite its ubiquity, the term ‘good faith’ is left undefined in the Uniform Contract Law. An indication of the judicial approach can be gleaned from the decision of the Beijing High People’s Court in 1999 in the case of *Wen Zaolun v Guang Xi Movie Studio and Guang Dong Full Stars Movie & TV Entertainment Inc.*<sup>21</sup> In that case, Wen Zaolun was engaged by a production company to play the lead in a major TV series. Some parts were filmed, and fees paid, but a third of the way through production Wen suffered a potentially serious kidney illness, and so requested sick leave and adjustments to the schedule. The production company at first acknowledged the request for sick leave and made some adjustments to the filming schedule, but then served notice that it was terminating the contract for: (a) Wen’s breach through failure to perform; and (b) in any event the uncertainty caused to the production company’s economic interests. The trial court, and subsequently the Beijing High People’s Court on appeal, considered the general principle of ‘good faith’ set out in Article 6 of the Uniform Contract Law meant that, so long as the parties had acted honestly in relation to the unexpected illness (Wen had requested the sick leave in good faith as a genuine response to an unexpected emergency and the production company honestly believed that the development jeopardized their economic interests), both could be released from their contractual obligations. Notably, the court did not seek to use the principle of good faith to imply any specific contractual obligations, but rather judged compliance with the ethic of good faith as a means by which parties’ contractual obligations could be disregarded.

5.4 Analysis. Chinese law, unlike the legal systems discussed above, has not grown from Roman or Anglo-Saxon roots. It has its own autonomous origins. The centrality of ‘good faith’ in Chinese contract law is a product of Chinese history and culture. Possibly it has its roots in Confucianism. Harmony between contracting parties is seen as the best way of promoting the common good. The

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<sup>17</sup> Uniform Contract Law, Article 42(1)-(3).

<sup>18</sup> Uniform Contract Law, Article 60.

<sup>19</sup> Uniform Contract Law, Article 92.

<sup>20</sup> Uniform Contract Law, Article 125.

<sup>21</sup> *Wen Zaolun v Guang Xi Movies Studio and Guang Dong Full Stars Move & TV Entertainment Inc*, Beijing High People’s Court. The case is reported in summary in Mo Zhang, *Chinese Contract Law: Theory and Practice* (2006), pp77-80 (Available on Google Books).

obligation to observe good faith is inherent in every contract. As set out above, it has a substantial impact on the parties' obligations and on the court's interpretation of those obligations.

## 6. CONSTRUCTION CONTRACTS

6.1 LB Merton v Leach. *London Borough of Merton v Leach* (1985) 32 BLR 51 (a case in which I appeared as junior counsel over thirty years ago) involved a contractor's claim for extensions of time, with consequential loss and expense. The contract was in the JCT Standard Form, 1963 – a form widely used in the industry for many years. Vinelott J held that there was an implied term that Merton would not hinder or prevent the contractor from carrying out its obligations in accordance with the terms of the contract and from executing the work in a regular and orderly manner; there was also an implied duty to do whatever was necessary in order to enable the contract to be carried out. The implementation of the contract required close co-operation between the contractor and the architect. Therefore, the implied undertaking by the building owner extended to those things which the architect must do to enable the contractor to carry out the work. The judge reached these conclusions applying basic general principles. He also held that there was no implied duty of good faith. Indeed, against that background, it is difficult to see what an implied duty of good faith would have added.

6.2 Modern construction contracts and PFI contracts. Construction contracts sometimes and PFI contracts generally have the incidents of 'relational contracts' as identified by Professor Collins. An example is the *Portsmouth City Council* case discussed in paragraphs 3.5 and 3.6 above. Many bespoke construction contracts and some standard forms now include 'good faith' requirements or similar provisions. In practice, it is difficult to see what these aspirational provisions add to the black letter terms of the contract.

6.3 In *Gold Group Properties Ltd v BDW Trading Ltd* [2010] EWHC 1632 a development agreement between the land owner and the developer contained a good faith clause. Mr Stephen Furst QC, sitting as a deputy High Court judge, rejected the submission that this obliged either party to accept less favourable financial terms following the property market crash in 2008. The judge observed at [91]:

“Thus good faith, whilst requiring the parties to act in a way that will allow both parties to enjoy the anticipated benefits of the contract, does not require either party to give up a freely negotiated financial advantage clearly embedded in the contract.”

6.4 The NEC suite of contracts. The NEC contracts expressly require parties to work together in a co-operative manner. Clause 10.1 of NEC3 provides:

“the [parties] shall act as stated in this contract and in a spirit of mutual trust and co-operation.”

Clause 10 of NEC4<sup>22</sup> provides:

“10.1: The Parties, the *Project Manager* and the *Supervisor* shall act as stated in this contract.

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<sup>22</sup> The NEC4 suite is an evolution of the existing NEC3, rather than a fundamental change: see M Bahl, 'Construction projects and risk management: NEC4 – the evolution of contracts', (2017) 33 Cons LJ 438-441.

10.2: The Parties, the *Project Manager* and the *Supervisor* act in a spirit of mutual trust and co-operation.”

6.5 *Costain v Tarmac*. In *Costain Ltd v Tarmac Holdings Ltd* [2017] EWHC 319 (TCC); [2017] BLR 239 Tarmac supplied concrete to Costain pursuant to the NEC3 Framework Contract Conditions (“NEC3 FC”) and the NEC3 Supply Short Contract Conditions (“NEC3 SST”). Clause 10.1 of NEC3 FC provided: “The Employer and the Supplier shall act as stated in this contract and in the spirit of mutual trust and co-operation.”

Clause 93 of NEC3 FC provided strict time limits for commencing adjudication and arbitration. Costain subsequently brought proceedings in the TCC because of defects in the concrete. Tarmac applied to stay the proceedings on the grounds that there was an arbitration clause. Tarmac also maintained that Costain could not pursue any adjudication or arbitration, because it had missed the time limit. Costain maintained that Tarmac was in breach of clause 10.1 by letting Costain fall into that trap. Coulson J rejected that submission.

6.6 At [129] – [124] Coulson J said:

“119. Now turn to whether or not clause 10 (the ‘mutual trust’ provision) makes any difference to this analysis. It appears that the claimant maintains that, even if (as I have found) the defendant said or did nothing which ‘crossed the line’ (i.e. made a representation that was inconsistent with the point they subsequently took) the defendant was in breach of clause 10.1 in any event. This rather startling submission means that, in essence, the claimant must argue that, as a result of the mutual trust obligation, the defendant had an express obligation to point out to the claimant the nature, scope and potential effect of clause 93 (including the time bar). I consider that to be contrary to the passages set out at paragraphs 102-108 above. In any event, for the reasons set out below, I reject that submission.

120. In *Keating on NEC3* (First Edition 2012) at paragraph 2-004, a parallel is drawn between ‘mutual trust and cooperation’ and obligations of ‘good faith’. The authorities dealing with ‘good faith’ are mainly from outside the United Kingdom, because good faith has not been, at least until recently, a concept that has gained much traction in the English common law. One of the leading Australian cases on the topic is *Automasters Australia PTY Limited v Bruness PTY Limited* [2002] WASC 286 which, as set out in *Keating NEC3* is authority for the following propositions:

- “(1) What is good faith will depend on the circumstances of the case and the context of the whole contract.
- (2) Good faith obligations do not require parties to put aside self-interests; they do not make the parties fiduciary.
- (3) Normal reasonable business behaviour is permitted but the court will consider whether a party has acted reasonably or unconscionably or capriciously and may have to consider motive.
- (4) The duty is one ‘to have regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.’”

121. *Keating* goes on to say that, in the light of that authority and other cases concerned with implied terms in employment contracts, the term of mutual trust and co-operation suggests that, whilst the parties can maintain their legitimate commercial interests, they must behave so that their words and deeds are “honest,

fair and reasonable, and not attempts to improperly exploit” the other party. Or as it is described in another Australian case, *Overlook v Foxtel* (2002) Aust Contract R 90-143, “a party is precluded from cynical resort to the black letter”.

122. For completeness, I note that, in *F & C Alternative Investments (Holdings) Limited v Barthelemy (Nos. 2 and 3)* [2011] EWHC 1731 (Ch) Sales J (as he then was), when dealing with an obligation of utmost good faith, referred to another Australian case (*Macquarie International Health Clinic PTY Limited v South West Area Health Service* [2010] NSWCA 268, and said that:

“It is a form of contractual duty which requires the obliger to have regard to the interests of the obligee, while also being entitled to have regard to its own self-interest when acting.”

123. I respectfully agree with that summary. I agree too with the passage in *Keating* about not improperly exploiting the other party, although I am a little uneasy about a more general obligation to act ‘fairly’; that is a difficult obligation to police because it is so subjective. Further, it might be said that the mutual trust provision does little more than say expressly what Vinelott J thought was implied into all construction contracts: see *Merton LBC v High Stanley Leach* (1986) 32 BLR 51.

124. Taking the obligation of mutual trust and co-operation (or even good faith) at its highest, it meant that, in the present case, the defendant could not do or say anything which lulled the claimant into falsely believing that the time bar in clause 93 was either non-operative or would not be relied on in this case. For this purpose, I am also prepared to accept that this obligation would go further than the negative obligation not to do or say anything that might mislead; it would extend to a positive obligation on the part of the defendant to correct a false assumption obviously being made by the claimant, either that clause 93 was not going to be operated or that the time bar provision was not going to be relied on. But beyond that, on any view of clause 10.1, there can have been no further obligation, because otherwise the provision would have required the defendant to put aside its own self-interest.”

6.7 Comment. I must be cautious in commenting on *Costain*, in case it comes to me on appeal. What is significant about that case is the judge’s valiant struggle to ascribe to clause 10.1 any meaning which was *additional* to the existing obligations. His reference to *Merton v Leach* is particularly pertinent.

6.8 Partnering contracts. Many partnering contracts use aspirational language about how well the parties will work together. When they subsequently fall out the courts face the problem of interpreting and applying those aspirational provisions. In *TSG Building Services v South Anglia Housing Ltd* [2013] EWHC 1151 (TCC) a contract for building and maintenance services contained the following provision at clause 1.1:

“The Partnering Team members shall work together and individually in the spirit of trust, fairness and mutual co-operation for the benefit of the Term Programme, within the scope of their agreed roles, expertise and responsibilities as stated in the Partnering Documents, and all their respective obligations under the Partnering Contract shall be construed within the scope of such roles, expertise and

responsibilities, and [3] in all matters governed by the Partnering Contract they shall act reasonably and without delay.”

Clause 2.1 provided:

“The Partnering Team members shall establish, develop and implement their partnering relationships, within their agreed roles, expertise and responsibilities and in accordance with the Partnering Documents, with the objectives of achieving for the benefit of the Term Programme and for the mutual benefit of Partnering Team members:-

(i) trust, fairness, mutual cooperation, dedication to agreed common goals and an understanding of each other’s expectations and values;”

Clause 13.3 of the contract permitted either party to terminate the contract for any reason or no reason. Akenhead J rejected the contention that the partnering provisions constrained the right of either party to terminate. He also rejected the contention that there was an implied term of good faith. He added that even if there was such an implied term it would not restrict the right of either party to terminate under clause 13.3.

6.9 In *Fujitsu Services Ltd v IBM United Kingdom Ltd* [2014] EWHC 752 (TCC) FSL agreed to provide IT services under a subcontract with IBM over a ten-year period, later extended to 13 years. The parties agreed to “comply with partnering principles”. IBM agreed to comply with “Good Industry practice”. Edwards-Stuart J rejected the contention that IBM owed FSL fiduciary duties. He also rejected the contention that there was any implied obligation of good faith in the contract.

6.10 What is the effect of an express ‘good faith’ obligation in a construction contract? A ‘good faith’ obligation in a construction contract may encourage an arbitrator or judge called upon to construe the contract to be ‘bold’: in other words, to be slightly more willing to give effect to the obvious purpose underlying the contract. But even with such a clause in place, there are strict limits to how far she or he can go: see *Arnold v Britton* [2015] UKSC 36; [2015] AC 1619. Where a contract bites upon the inner thoughts of a party, a ‘good faith’ obligation may add a specific duty, the obvious example being an obligation to negotiate or mediate in good faith. It is doubtful that an obligation of good faith adds to the obligation of a certifier beyond what is already spelt out in the general law.

6.11 If a construction contract contains no express ‘good faith’ provision, should one generally be implied? No. There is generally no reason to imply such a nebulous provision of little utility. There is also a wider policy consideration. A large number of individuals, who had nothing to do with drawing up the contract, have to operate in accordance with its provisions. Some may be employees of the building owner or contractor. Others may be outsiders, such as certifiers or measurers or subcontractors. They all need to know what the contract requires and what the contract permits. To that end, they do not speculate about ethics or metaphysics. Nor do they ring up their lawyers at every turn. They look at the black letter provisions of the contract. That is what the court should do as well.

Rupert Jackson

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