

# The Implication of Terms-in-Fact: Good Faith, Contextualism, and Interpretation

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## ABSTRACT

*U.S. contract law has a rich heritage of good faith jurisprudence. By contrast, the good faith jurisprudence of the United Kingdom is relatively under-developed. This Essay undertakes to examine the role of good faith in the implication of terms-in-fact in British contract law. The analysis extends to both English and Scottish cases, with some comparative reference to U.S. law. The Essay begins by exploring the values and standards that good faith connotes. A distinction is then drawn between two uses of good faith: procedural good faith (that is, using good faith to decide whether to imply terms) and substantive good faith (implying terms whose content requires adherence to a good faith standard). British courts have not been receptive to procedural good faith, but there is a growing body of cases in which substantive good faith has been implied by courts, especially with respect to relational contracts. In adjudicating whether to imply terms of a good faith nature, courts have sought to take account of the intention of the parties and have taken a highly contextual approach.*

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INTRODUCTION

The implication of terms into specific contracts (“implied-in-fact” terms) touches upon a number of fundamental aspects of contract law: freedom of contract, the purposes for which parties enter into contracts, the role of courts in relation to gap-filling, and the relationship between gap-filling and interpretation of express terms. The interaction of these issues is complex and in recent times has become more so given the burgeoning jurisprudence on the role that good faith may have in relation to implication of terms.

The questions raised in this field may be considered from both a jurisdiction-specific and a comparative perspective. From a jurisdiction-specific perspective, some jurisdictions have more settled approaches to good faith than others. The U.S. common law position is easier to identify—a rule of good faith has been built into both the Uniform Commercial Code (“UCC”)<sup>1</sup> and the Restatement (Second) of Contracts.<sup>2</sup> The narration of the good faith duty in each instrument is almost identical, with the UCC version stating that “[e]very contract or duty . . . imposes an obligation of good faith in its performance and enforcement.”<sup>3</sup> This is narrower than the commonly adopted sphere of application of good faith in civilian systems; and in the United States, there remains a debate about what good faith means and what exactly it might prescribe in specific cases, but at least the existence of the succinctly expressed rule is indisputable. The same cannot be said for English law, which lacks any legislative provision comparable to that found in the UCC, and where the tradition of Restatements is in its infancy.<sup>4</sup>

From a comparative perspective, the European civilian systems and English common law have traditionally taken divergent approaches: the civilian jurisdictions have continued to take the idea of a distinct general principle of good faith seriously, while English common law—following initial hints during the era of Lord Mansfield that commercial contract law might be permeated by such a principle—has

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1 U.C.C. § 1-304 (AM. LAW INST. & UNIF. LAW COMM’N 2011).

2 RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981).

3 U.C.C. § 1-304.

4 The first English foray in this field is ANDREW BURROWS, *A RESTATEMENT OF THE ENGLISH LAW OF CONTRACT* (2016), but this is a privately produced work rather than the product of a legal institute or law reform body.

shunned the language of good faith in favor of isolated doctrines dealing with aspects of unfairness and unconscionable conduct.<sup>5</sup> Lord Justice Bingham memorably summed up the difference in approach:

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. . . .

English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.<sup>6</sup>

The author's home jurisdiction of Scotland is neither wholly common law nor wholly civilian, but rather a mixed legal system. Perhaps appropriately, the views on the role which good faith ought to play in it have themselves been rather mixed. Some scholars have promoted the idea of good faith as an umbrella concept capable of explaining scattered contractual doctrines and (within limits) of developing the law,<sup>7</sup> or even the view that good faith lies at the heart of every contractual relationship.<sup>8</sup> Others have been more skeptical, arguing that a rule requiring a party to act in good faith when contracting with another "undermines the whole rationale of contractual freedom."<sup>9</sup> This breadth of opinion stands rather in contrast to the English scholarly landscape, where good faith skepticism has predominated (without

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<sup>5</sup> See *Carter v. Boehm* (1766) 97 Eng. Rep. 1162, 1164; 3 Burr. 1905, 1910 (Lord Mansfield) ("The governing principle is applicable to all contracts and dealings. Good faith forbids either party [from] concealing what he privately knows, to draw the other [party] into a bargain, from his ignorance of that fact, and his believing the contrary."). Lord Mansfield was concerned here with a duty to disclose certain facts within the context of the formation of a contract of insurance; on the facts, he held the duty not to have been breached by the insured party. *Id.* at 1169; 1918–19. In *Manifest Shipping Co. v. Uni-Polaris Insurance Co.* [2001] UKHL 1 [42], [2003] 1 AC 469 (HL) 491 (appeal taken from Eng.), Lord Hobhouse said: "Lord Mansfield was at the time attempting to introduce into English commercial law a general principle of good faith, an attempt which was ultimately unsuccessful and only survived for limited classes of transactions, one of which was insurance."

<sup>6</sup> *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.* [1989] 1 QB 433 (CA) at 439 (Lord Bingham LJ) (appeal taken from Lambeth Cty. Ct.) (Eng.).

<sup>7</sup> See Hector L. MacQueen, *Good Faith in the Scots Law of Contract: An Undisclosed Principle?*, in *GOOD FAITH IN CONTRACT AND PROPERTY* 5, 7 (A.D.M. Forte ed., 1999).

<sup>8</sup> See 11 THE LAW SOC'Y OF SCOT., *THE LAWS OF SCOTLAND: STAIR MEMORIAL ENCYCLOPAEDIA* ¶ 1129 (Thomas Smith et al. eds., 1990) ("Conventional obligations can themselves be considered as exigible simply on grounds of the requirements of good faith. Each party to a contract necessarily engages the trust of the other . . .").

<sup>9</sup> Joseph M. Thomson, *Good Faith in Contracting: A Sceptical View*, in *GOOD FAITH IN CONTRACT AND PROPERTY*, *supra* note 7, at 63–64.

being universal)<sup>10</sup> among legal scholars. Recent Scottish caselaw, however, has typically followed the English generally skeptical lead, with one (notably Anglophile) judge commenting, “It is, of course, no part of Scots law that, in the absence of agreement, parties to a contract should act in good faith in carrying out their obligations to each other.”<sup>11</sup> The suggestion made in an earlier House of Lords Scottish appeal that there is a “broad principle in the field of contract law of fair dealing in good faith”<sup>12</sup> has not thus been firmly echoed by later judges.

Following a brief discussion on the meaning of good faith, the remainder of this Essay offers analysis structured in part around a division between two roles for good faith: one procedural and the other substantive. The focus of the discussion is on English and Scottish common law, with some additional reference to U.S. law. The suggested procedural-substantive division posits a difference between, on the one hand, using good faith as a reason to imply a term (procedural good faith) and, on the other, implying a term that a party has to conduct itself in good faith (substantive good faith).

The first role would see good faith operating as a gateway or threshold (conceivably as an alternative to the traditional threshold of necessity) for justifying the implication of a term-in-fact, the argument being that it would be consistent with the good faith relationship of the parties to imply a suggested term (the content of the term might or might not make reference to good faith). One is not likely to find evidence of this role for good faith in the British courts: those courts have in the past shown themselves unwilling to use “reasonableness” as a basis upon which to imply terms,<sup>13</sup> and identical or similar concerns to those arising when rejecting reasonableness also arise in respect of good faith. The principal concerns are that procedural good faith would encourage judicial activism and infringe on the autonomy and contractual freedom of parties. Additionally, implying terms for reasons of good faith would produce an inconsistency with the traditional “necessity” test for implication—such a test imposes a higher hurdle for implication than does good faith, as many implied terms

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<sup>10</sup> For a more positive view, see generally David Campbell, *Good Faith and the Ubiquity of the ‘Relational’ Contract*, 77 MOD. L. REV. 475 (2014), which supports the view that the body of specific duties in English law together constitutes a doctrine of good faith and does the same work as a general doctrine.

<sup>11</sup> EDI Cent. Ltd. v. Nat’l Car Parks Ltd. [2010] CSOH 141 [23] (Lord Glennie) (Scot.).

<sup>12</sup> Smith v. Bank of Scotland [1997] UKHL 26, (1997) SC (HL) 111, 121 (Lord Clyde) (appeal taken from Scot.).

<sup>13</sup> See *infra* Part II.

which might be consistent with a good faith contractual relationship would not necessarily be required to give business efficacy to the contract.<sup>14</sup>

The second role for good faith relates to the content of implied terms: the language of good faith might be used when framing contractual duties (or, without expressly mentioning good faith, when framing implied terms with a similar substantive effect). The employment of good faith in defining the content of implied-in-fact terms might happen at a very generalized level, for instance through specification that “each party shall perform its obligations under the contract in a manner consistent with good faith” or “each party shall exercise its remedies under this contract in a manner consistent with the good faith nature of the parties’ relationship.” It also might be used in describing more specific duties, for instance by specifying that “the customer shall act in a way consistent with good faith when considering requests for extensions of time under this clause” or “if the price adjustment mechanism under this clause is activated by either party, the parties shall re-negotiate the price in good faith.” An example of a term which, though not explicitly mentioning good faith, could be described as substantively reflecting the concept would be one specifying that “the parties shall co-operate to ensure that their respective obligations under the contract are performed, and that their respective aims in entering into the contract are achieved.”<sup>15</sup> An early reported example of this sort is the Scottish House of Lords appeal, *Mackay v. Dick*,<sup>16</sup> in which a term was implied that each party undertook to do all that was necessary for the carrying out of matters which could only be achieved with the concurrence of both parties (in other words, a duty of mutual cooperation).<sup>17</sup>

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<sup>14</sup> See *infra* Part II.

<sup>15</sup> The contract at issue in *TSG Building Services PLC v. South Anglia Housing Ltd.* [2013] EWHC (TCC) 1151, contained such a term, requiring that “[t]he 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 . . . and in all matters governed by the Partnering Contract they shall act reasonably and without delay.” *Id.* [4]. A somewhat similar sort of circumstance is that of an implied obligation *not* to do something because doing the interdicted conduct would thwart the contract’s purposes. See *Berkeley Community Villages Ltd. v. Pullen* [2007] EWHC (Ch) 1330 [66], [67], [134] (Eng.), where (on the assumption that its first decision on an express obligation was incorrect) the court was willing to imply a term requiring the defendants not to sell some land, because to do so would disable them from performing various obligations imposed on them under a contract between the parties.

<sup>16</sup> (1881) 6 App. Cas. 251 (HL) (appeal taken from Scot.).

<sup>17</sup> See *id.* at 263 (Lord Blackburn). In fact, the view was expressed in the House of Lords that such a term was to be implied into *all* contracts, and not just that before the court, so this is really an example of a term implied-at-law and not just in fact.

## I. DEFINITIONAL MATTERS

Before analyzing procedural and substantive good faith in more detail, something should briefly be said about the perennially thorny issue of how to define the idea of good faith.

Good faith (or functionally equivalent ideas), a concept of some antiquity,<sup>18</sup> can be described in broad-brush terms. At its most broad-brush, one might describe good faith as “behaving decently”; one may then have to give regard to community standards of decency to decide exactly what conduct is mandated in specific circumstances (the UCC speaks of “reasonable commercial standards of fair dealing”<sup>19</sup>). Being a little more specific, certain fundamental characteristics of “decent” behavior have been suggested, most commonly honesty,<sup>20</sup> openness,<sup>21</sup> loyalty/fidelity,<sup>22</sup> and mutual trust and confidence.<sup>23</sup> Such qualities have, in appropriate cases, been transformed by courts into legal duties to be honest, open, loyal, and trustworthy (such duties sometimes being translated into even more specific duties, as discussed in Section

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18 The concept of *bona fides* (good faith) in Roman law is the primary historical source of the notion of good faith in modern Civilian jurisprudence. See Robert H. Jerry, II, *The Wrong Side of the Mountain: A Comment on Bad Faith's Unnatural History*, 72 TEX. L. REV. 1317, 1319–37 (1994) (outlining the evolution of good faith from Roman law through canon, English, and American law). Modern Greek law also draws on the ancient Greek concept of *pistis* (πίστις) meaning faithfulness, a term also employed in passages of the New Testament. See Dimitrios Kremalis, *Good Faith in Greek Employment Law*, 32 COMP. LAB. L. & POL'Y J. 631, 634–41 (2011) (discussing origins of good faith doctrines and impact on modern Greek employment law). See generally JAMES L. KINNEAVY, GREEK RHETORICAL ORIGINS OF CHRISTIAN FAITH: AN INQUIRY (1987) (interpreting the usage of the word *pistis* in the New Testament).

19 U.C.C. § 1-201(b)(20) (AM. LAW INST. & UNIF. LAW COMM'N 2014).

20 Honesty is a quality said in *Yam Seng Pte. v. International Trade Corp.* [2013] EWHC (QB) 111 [135] (Eng.) to underlie “almost all contractual relationships.” See also *HIH Cas. & Gen. Ins. Ltd. v. Chase Manhattan Bank* [2003] UKHL 6 [15] (Lord Bingham of Cornhill) (appeal taken from Eng.) (“Parties entering into a commercial contract . . . will assume the honesty and good faith of the other; absent such an assumption they would not deal.”). The UCC highlights honesty as a principal quality of good faith. See U.C.C. § 1-201(b)(20).

21 [I]n so far as English law may be less willing than some other legal systems to interpret the duty of good faith as requiring openness of the kind described by Bingham LJ in the *Interfoto* case as ‘playing fair,’ ‘coming clean’ or ‘putting one’s cards face upwards on the table,’ this should be seen as a difference of opinion, which may reflect different cultural norms, about what constitutes good faith and fair dealing in some contractual contexts rather than a refusal to recognize that good faith and fair dealing are required.

*Yam Seng* [2013] EWHC [151] (quoting *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.* [1989] 1 QB 433 (CA) at 439 (Lord Bingham LJ) (appeal taken from Lambeth Cty. Ct.) (Eng.)).

22 “Another aspect of good faith . . . is what may be described as fidelity to the parties’ bargain.” *Id.* [139].

23 *Id.* [142].

III.B.4). This approach has the virtue of employing succinct, intuitive qualities, and has been a favored approach of British courts in those cases where good faith arguments have been successful before them. Were one to take a more skeptical view, it might be said that the alleged umbrella concept of good faith is redundant, given judicial reference to, and deployment of, these more specific qualities.

An alternative approach to the definitional question would be to attempt to provide a more detailed, comprehensive definition. In discussing the topic of good faith with his students, the author has ventured on occasion to offer one such definition (without suggesting that this is necessarily the preferred way of seeing good faith). That suggested definition is as follows:

The duty to act honestly and openly in one's dealings with the other party, which includes (but is not limited to) not seeking to take undue advantage of the other party, disclosing all such information to the other party the failure to disclose which would distort an honest and open relationship, and treating the other party not simply as an adversary but as a co-operative agent.<sup>24</sup>

This comprehensive definition builds upon elements of good faith practice which have cropped up repeatedly in the pleadings of cases. While this approach offers a supposedly complete set of suggested issues for examination, its weakness is that it is a bit of a mouthful, something which the author's students have not failed to point out. Moreover, as an attempt at comprehensiveness, it runs the risk of having ignored further fundamental aspects of good faith which might later be argued to be necessary for any comprehensive definition (and which would presumably then have to be added in order to make for an even longer definition).

A third approach would be to argue that good faith has no universally applicable content, but rather acquires a variable, contextual meaning which is dependent upon the specific facts of particular contractual relationships. Professor Hugh Beale (one of the editors of *Principles of European Contract Law*)<sup>25</sup> has explored this approach in some of his writing,<sup>26</sup> though he has also suggested that, in some cases,

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<sup>24</sup> MARTIN HOGG, OBLIGATIONS 37 (2d ed. 2006).

<sup>25</sup> COMM'N OF EUR. CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW: PARTS I AND II (Ole Lando & Hugh Beale eds., 2000).

<sup>26</sup> See generally Hugh Beale, *General Clauses and Specific Rules in the Principles of European Contract Law: The 'Good Faith' Clause*, in GENERAL CLAUSES AND STANDARDS IN EUROPEAN CONTRACT LAW 205 (Stefan Grundmann & Denis Mazeaud eds., 2006).

good faith ultimately boils down to reasonableness.<sup>27</sup> An approach of undefined but variable content suffers from the obvious weakness: that, by making it mean whatever we want it to mean, the concept becomes meaningless. Furthermore, if some anchor for a context-specific approach is needed, such that we end up saying that good faith is just reasonableness, why then duplicate what we already have in the distinct concept of reasonableness?

The point in briefly examining these definitional issues is not only to point out that the British courts have favored the first approach to the definition of good faith (i.e., the aspects of behaving decently approach); it is also to argue that whichever definitional approach to good faith one chooses—say, for argument’s sake, it is indeed the first approach—that approach could be applied both to what this Essay calls procedural good faith and to substantive good faith. In other words, however we identify communitarian qualities of decent behavior, we could use them both as potential reasons to imply terms into contracts and to frame the content of any terms so implied. Despite this definitional flexibility, the following section will go on to develop the argument that good faith is *not* a sufficient ground for implying a term into a contract.

Whichever approach one takes to defining good faith, debates remain in European contract law as to whether it is a characteristic of all contractual relationships (a question of fact) or at least ought to be presumed to be so (a normative question).<sup>28</sup> The suggestion that good faith characterizes *all* contracts, as a matter of fact, is an unconvincing, fictional, paternalistic, and rose-tinted view. Sometimes, contracting parties are thrown together in less than ideal circumstances and may be forced to contract out of necessity rather than preference. In such cases, each party may in reality be trying to squeeze out the best possible bargain, may mistrust the other party, may attempt to avoid transparency, may demonstrate little cooperation, and may feel little sense of loyalty to the other party. Even if some such contracts are “relational,” they are surely very imperfect relations. While it is not benefi-

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<sup>27</sup> *Id.* at 216.

<sup>28</sup> See, e.g., Madeleine van Rossum, *The Principles of European Contract Law, A Review Essay*, 3 MAASTRICHT J. EUR. & COMP. L. 69, 72–73 (1996). But see Larry A. DiMatteo, *Contract Talk: Reviewing the Historical and Practical Significance of the Principles of European Contract Law*, 43 HARV. INT’L L.J. 569, 575 n.18 (2002). In the United States, however, many jurisdictions have held that all contracts contain an implied covenant of good faith and fair dealing. See, e.g., *Sutherland v. Barclays Am./Mortg. Corp.*, 61 Cal. Rptr. 2d 614, 623 (Ct. App. 1997); *Morris v. Macione*, 546 So. 2d 969, 971 (Miss. 1989); *Sons of Thunder, Inc. v. Borden, Inc.*, 690 A.2d 575, 587 (N.J. 1997).

cial to deny such contracts the force of law, if good faith is not (as a matter of fact) present in such relationships, it seems absurd to require it by way of an implied legal duty. That is not to say, however, that even in contracts where the parties mistrust each other, there should not be those minimal requirements of fairness necessary to make the contract work. These requirements are embodied in established contractual rules—e.g., in rules against positive deception, rules related to the principle of mutuality of contract, and rules regulating the enforcement of remedies. Such rules *do* apply to all contracts, but they need not be absolutely justified in good faith terms. Judicial commentary on the issue of whether one needs to see good faith as underlying all instances of contract, or rather (as I contend) that the presence or absence of a good faith relationship is a matter of fact to be judged in each case, would be welcome.

## II. USING GOOD FAITH TO IMPLY TERMS-IN-FACT (PROCEDURAL GOOD FAITH)

As well as expressing the sorts of decent behavior identified in the previous section, it is often said that good faith has a connection with the qualities of reasonableness and fairness. Specifically, it can be argued that that which accords with good faith must be fair and reasonable, and thus not excessively in favor of the interests of one party or the other.<sup>29</sup> On this view, reasonableness and fairness may be seen as component qualities of the broader concept of good faith. That being so, it is important to recall that, in numerous judgments, the British courts have made the point that, just because it might be fair and reasonable to do so, that is *not* a sufficient ground for implying a term into a contract; rather, it is a necessary but not sufficient requirement that it should be reasonable and equitable to imply any argued for implied term. This stipulation was identified by Lord Simon in a decision of the Privy Council as one of five requirements for implying term in fact:

[F]or a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that “it goes

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<sup>29</sup> Sometimes fairness is said to be inherent in good faith; sometimes it is said to be closely related but distinct (as when the phrase “good faith and fair dealing” is employed). See, e.g., Rossum, *supra* note 28, at 72–74.

without saying”; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.<sup>30</sup>

The necessity, but insufficiency, of fairness and reasonableness was echoed in the recent comments of Lord Neuberger in the U.K. Supreme Court case of *Marks & Spencer plc v. BNP Paribas Securities Services Trust Co. (Jersey)* (“*M&S*”).<sup>31</sup> His lordship said that “a term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them. Those are necessary but not sufficient grounds for including a term.”<sup>32</sup> Lord Neuberger went further and added, in relation to Lord Simon’s requirement of reasonableness and equity, that “it is questionable whether Lord Simon’s first requirement, reasonableness and equitableness, will usually, if ever, add anything: if a term satisfies the other requirements, it is hard to think that it would not be reasonable and equitable.”<sup>33</sup> So, that it would be reasonable to imply a term is not enough to permit a court to do so.

The position adopted by British courts on these matters is comparable to that found in section 204 of the Restatement (Second) of Contracts: “When the parties . . . have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court.”<sup>34</sup>

The second and third of Lord Simon’s above-noted requirements condense what are respectively known as the “business efficacy” test and the “officious bystander” test for implication.<sup>35</sup> The status of these two tests has at times been somewhat uncertain: are they alternative tests, fulfilment of either satisfying the hurdle for implication, or are they cumulative? The view of Lord Neuberger in *M&S* was that the two tests “can be alternatives in the sense that only one of them needs to be satisfied, although I suspect that in practice it would be a rare

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<sup>30</sup> BP Refinery (Westernport) Pty. v. Shire of Hastings (1977) 180 CLR 266, 283 (PC) (Lord Simon of Glaisdale) (Austl.).

<sup>31</sup> [2015] UKSC 72, [2016] AC 742 (appeal taken from Eng.)

<sup>32</sup> *Id.* [21] (Lord Neuberger P).

<sup>33</sup> *Id.* [21].

<sup>34</sup> RESTATEMENT (SECOND) OF CONTRACTS § 204 (AM. LAW INST. 1979).

<sup>35</sup> So-called as a result of the remark of Lord Justice MacKinnon in *Shirlaw v. Southern Foundries (1926) Ltd.* [1939] 2 KB 206 (CA) at 227 (Eng.), that an implied term is one which is so obvious that, were an officious bystander to suggest it, the contracting parties would reply: “Oh, of course!”

case where only one of those two requirements would be satisfied.”<sup>36</sup> The two tests were again used as dual checks in the more recent U.K. Supreme Court case of *Airtours Holidays Transport Ltd. v. Commissioners for Her Majesty’s Revenue & Customs*,<sup>37</sup> itself referred to approvingly in the Scottish first instance case of *Acotec UK Ltd. v. McLaughlin & Harvey Ltd.*<sup>38</sup> Additionally, the business efficacy test was very recently applied by the U.K. Supreme Court in *Impact Funding Solutions Ltd. v. AIG Europe Insurance Ltd.*<sup>39</sup>

It is these traditional tests for implication, set in the context of Lord Simon’s five points listed above, which act as a guide for British courts when implying terms in fact. The radical attempt by Lord Hoffmann in *Attorney General of Belize v. Belize Telecom Ltd.*<sup>40</sup> to align implication with the process of interpretation of contract did not find favor among the later *M&S* Supreme Court bench<sup>41</sup>: Lord Neuberger warned that “Lord Hoffmann’s analysis in *Belize Telecom* could obscure the fact that construing the words used and implying additional words are different processes governed by different rules.”<sup>42</sup> Lord Hoffmann’s approach to interpretation of contract was that of what might be called “broad contextualism,” i.e., of taking into account any information which might be relevant to the meaning of the parties’ agreement. The Supreme Court in *M&S* has distanced itself from the view that interpretation and implication are part of the same task of discovering what the contract means; does this mean that the *M&S* Court did not see the task of implication as in some way contextual? No. Context was thought to be important to the process of implication, Lord Neuberger noting:

[T]he factors to be taken into account on an issue of construction, namely the words used in the contract, *the surrounding circumstances known to both parties at the time of the contract*, commercial common sense, and the reasonable

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<sup>36</sup> *M&S* [2015] UKSC [21] (Lord Neuberger P).

<sup>37</sup> [2016] UKSC 21 [38] (Lord Neuberger P) (appeal taken from Eng.).

<sup>38</sup> [2016] CSOH 134 [18] (Lord Doherty) (Scot.).

<sup>39</sup> [2016] UKSC 57 [31]–[32], *sub nom* *Impact Funding Sols. Ltd v. Barrington Support Servs. Ltd* [2017] AC 73 at 84–85 (Lord Hodge SCJ) (appeal taken from Eng.).

<sup>40</sup> [2009] UKPC 10 [27] (Lord Hoffmann) (appeal taken from Belize).

<sup>41</sup> *M&S* [2015] UKSC 72 [31], [2016] AC 742 at 755 (Lord Neuberger). *Contra id.* [58] (Lord Carnwath SCJ, concurring) (expressing agreement with the approach adopted in *Belize*).

<sup>42</sup> *Id.* [26]. This view has been the subject of later favorable judicial citation. *See, e.g.*, *Globe Motors, Inc. v. TRW Lucas Varity Elec. Steering Ltd.* [2016] EWCA (Civ) 396 [68] (Lord Beatson LJ) (appeal taken from Eng.).

reader or reasonable parties, are *also taken into account on an issue of implication*.<sup>43</sup>

The surrounding circumstances, i.e., the context in which the contract was made, are thus to be taken into account when deciding whether or not to imply a term.

If there is, according to the *M&S* Court, a difference between interpretation and implication, and yet context is important to both processes, how then does each process differ (specifically, how is the role of context different in each)? Analyzing the recent jurisprudence of the Supreme Court, including the decision in *M&S*, it seems that the difference is twofold:

(1) The process of implication only begins (says Lord Neuberger in *M&S*) “after the process of construing the express words is complete”<sup>44</sup> (a view reaffirmed in the *Impact Funding Solutions* case<sup>45</sup>). The two are not, in some sense, alternative processes, and it is not permissible to seek to persuade a court to interpret a contract in such a way that it is effectively implying a good faith based duty.<sup>46</sup>

(2) In relation to the process of interpretation, the recent trend of the Supreme Court has been to pay greater attention to the express words of the parties, and in particular, their primary meaning in ordinary speech.<sup>47</sup>

On this approach, the wider context—the surrounding circumstances—may sometimes not need to be considered when a contract is being interpreted. In relation to implication, the approach is different: the wider context can always be considered as part of the exercise of implication, so long as what that wider context suggests does not contradict any express term of the contract (the fifth of Lord Simon’s

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<sup>43</sup> *M&S* [2015] UKSC 72 [27] (Lord Neuberger P) (emphasis added).

<sup>44</sup> *Id.* [28].

<sup>45</sup> See *Impact Funding Sols. Ltd. v. AIG Eur. Ins. Ltd.* [2016] UKSC 57 [31], *sub nom* *Impact Funding Sols. Ltd v. Barrington Support Servs. Ltd* [2017] AC 73 at 84 (Lord Hodge SCJ) (appeal taken from Eng.).

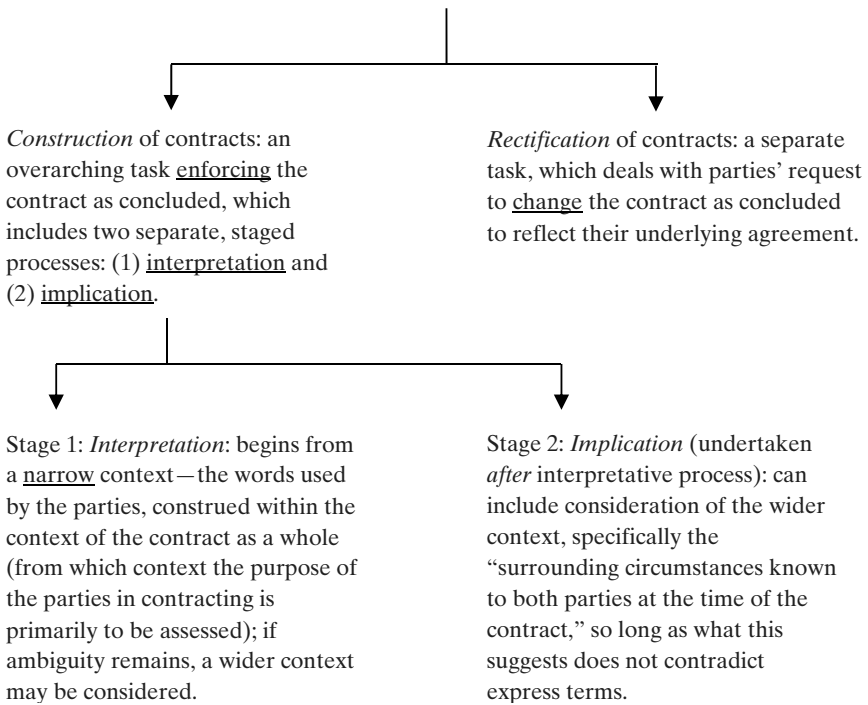
<sup>46</sup> In this respect, note the warning given by Lord Justice Beatson in *Globe Motors*: “[C]are must be taken not to seek to achieve that which might be achieved by implication by an inappropriate approach to interpretation,” *Globe Motors* [2016] EWCA (Civ) 396 [71]. In the matter before Lord Justice Beatson, breach of an implied obligation would have been time-barred, which encouraged him not to interpret the contract in the way argued for by the appellant. *Id.* [87]. It is, however, noteworthy that Lord Justice Beatson seems to view the question of implication as one *prior* to that of interpretation of the express terms: “[O]nce an implied term is excluded and the question is what the language of the Agreement permits, I consider that it was not open to the judge to interpret the terms of the Agreement in the way he did.” *Id.* This is at odds with the approach of the Supreme Court in *M&S*. [2015] UKSC 72 [28].

<sup>47</sup> See *Arnold v. Britton* [2015] UKSC 36 [56], [2015] AC 1619 at 1636 (Lord Neuberger P) (appeal taken from Wales.).

rules). That said, it is noticeable that the “factual background,” as described in the judgment of Lord Neuberger in *M&S*, makes no reference to the background circumstances surrounding the formation of the contract.<sup>48</sup> In deciding whether or not to imply a term, the *M&S* Court did not concern itself with what was in the minds of the actual parties to the case,<sup>49</sup> but only with the terms of the lease against the relevant background common law and statutory rules.

Figure 1 below summarizes what one can discern from the judgments of the post-Hoffmann, Neuberger Supreme Court about judicial determination of parties’ disputes concerning the terms of their contracts:

FIGURE 1. THE JUDICIAL TASK OF DETERMINING THE TERMS UPON WHICH PARTIES HAVE CONTRACTED



<sup>48</sup> [2015] UKSC 72 [9]–[13].

<sup>49</sup> Indeed, as Lord Neuberger notes in *M&S*:

Lord Steyn rightly observed that the implication of a term was ‘not critically dependent on proof of an actual intention of the parties’ when negotiating the contract. If one approaches the question by reference to what the parties would have agreed, one is not strictly concerned with the hypothetical answer of the actual parties, but with that of notional reasonable people in the position of the parties at the time at which they were contracting.

*Id.* [21] (quoting *Equitable Life Assurance Soc’y v. Hyman* [2002] 1 AC 408 (HL) 459 (Lord Steyn)).

The principal points to emphasize, for present purposes, about the above discussion are: (1) reasonableness is *not* a sufficient ground for implying a term (or indeed for interpreting a word or phrase in a particular way); (2) one cannot try to circumvent that position by seeking to persuade a court (at stage one of the process of construction) to interpret a term in a way which is reasonable (or consistent with a good faith relationship); but (3) although reasonableness is not a sufficient criterion for implying a term, any term to be implied into a contract must be reasonable, and thus one to which “notional reasonable people in the position of the parties”<sup>50</sup> would have acceded had they addressed their minds to the matter in question.

How can one extend these points about the role of reasonableness in the process of implication of contractual terms to good faith? This Essay suggests as follows: (1) courts cannot imply terms simply because they believe that notional contracting parties acting in good faith would have acceded to them. Such an approach would be as much (if not more) of a short circuit of the traditional tests for implication as the reasonableness threshold for implication to which the courts have objected; (2) going further, because good faith does *not* characterize all contractual relationships, the author believes that a British court would not say that, speaking in general terms, any term which is to be implied under the traditional tests must necessarily be one which is consistent with good faith. Good faith is thus, in general, neither a necessary nor sufficient reason for implying a term into a contract. Of course, matters will be otherwise where the relationship in question is, as a matter of fact, characterized by good faith. In such a case, any term to be implied would be one to which notional parties acting in good faith would have acceded as well as one which is necessary to make commercial sense of the contract.

### III. WRITING GOOD FAITH INTO IMPLIED TERMS (SUBSTANTIVE GOOD FAITH)

The Essay now turns to substantive good faith—the incorporation of the good faith standard into terms implied into specific contracts.

In the exercise of implying terms into specific contracts, British courts have consistently said that context is paramount. That was one of the clear messages in the important judgment of Justice Leggatt in *Yam Seng Pte. v. International Trade Corp.*,<sup>51</sup> which has been the sub-

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<sup>50</sup> *Id.*

<sup>51</sup> [2013] EWHC (QB) 111 [141]–[142] (Leggatt J.) (Eng.).

ject of much analysis<sup>52</sup> as well as subsequent citation by the English Court of Appeal in 2016.<sup>53</sup> In his judgment, Justice Leggatt also made it clear that implication hinged crucially on the “presumed intention of the parties.”<sup>54</sup> Context and intention are undoubtedly interrelated: some contexts will make it easier to presume the relevant party intention than others.

So, what exactly does substantive good faith require when implied into contracts, and how does the context of the parties’ relationship affect whether good faith terms are appropriate for implication?

### A. *What Does Good Faith Require by Way of Content?*

The broad requirements of good faith (discussed earlier in Part I) are usually said to crystallize into more specific requirements in argued-for good faith based implied terms.<sup>55</sup> Some of these requirements, however, could alternatively be considered to be inherent features of *all* contracts, rather than simply of those characterized by good faith. So, for instance, fidelity to the contract agreed by the parties could be characterized as a requirement deriving as a matter of course from the fact that the parties’ relationship has been embodied in a binding obligational form: the law, and not just the idea of good faith, requires us to adhere to contracts into which we have entered. That is the very nature of an *obligatio* (legal bond). There is thus a debate to be had about the extent to which some aspects of contractual relationships are best embodied in generally applicable contractual rules rather than implied terms. (This Essay returns to this issue below in Section III.B.3, when discussing good faith and remedial entitlement.)

One thing which has consistently been observed by common law courts is that good faith does *not* require an absolute subservience of the interests of one party to those of another. Making this point, the Australian Justice Barrett commented:

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<sup>52</sup> See, e.g., Ewan McKendrick, *Good Faith in the Performance of a Contract in English Law*, in *COMPARATIVE CONTRACT LAW: BRITISH AND AMERICAN PERSPECTIVES* 196 (Larry A. DiMatteo and Martin Hogg eds., 2016).

<sup>53</sup> See *Globe Motors, Inc. v. TRW Lucas Varity Elec. Steering Ltd.* [2016] EWCA (Civ) 396 [67] (Lord Beatson LJ) (appeal taken from Eng.).

<sup>54</sup> *Yam Seng* [2013] EWHC (QB) 111 [131] (Eng.).

<sup>55</sup> In *Yam Seng*, for instance, the two specific terms argued for were (1) that the defendant would not instruct or encourage the claimant “to incur marketing expenses . . . for products which it was unable or unwilling to supply,” and that it would not “offer false information on which [the claimant] was likely to rely,” and (2) that the defendant “would not prejudice [the claimant’s] sales by offering the same products for sale within the same territories at a lower price than [the claimant] was permitted to offer.” [2013] EWHC (QB) 111 [155], [157].

It must be accepted that the party subject to the obligation is not required to subordinate the party's own interests, so long as pursuit of those interests does not entail unreasonable interference with the enjoyment of a benefit conferred by the express contractual terms so that the enjoyment becomes (or could become) . . . "nugatory, worthless or, perhaps, seriously undermined."

. . . .

. . . [T]he implied obligation of good faith underwrites the spirit of the contract and supports the integrity of its character. A party is precluded from cynical resort to the black letter. But no party is fixed with the duty to subordinate self-interest entirely which is the lot of the fiduciary[.] The duty is not a duty to prefer the interests of the other contracting party. It is, rather, a duty to recognise and to have due regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.<sup>56</sup>

These remarks were cited approvingly by the English High Court in *Gold Group Properties Ltd. v. BDW Trading Ltd.*<sup>57</sup>

So, good faith permits some self-interest, but self-interest that nonetheless reflects the qualities mentioned earlier: honesty, openness, loyalty/fidelity, mutual trust and confidence. But when might implied duties reflecting such values be appropriate?

#### *B. The Nature of the Parties' Relationship and Its Effect Upon Implied Good Faith Duties*

The specific context of parties' relationships has been said to affect the likelihood of good faith based terms being implied into their contract. In particular, recent jurisprudence has suggested that there is something special about "relational" contracts so far as the content of the good faith based terms which are to be implied is concerned.

##### *1. What Is a "Relational" Contract?*

The concept of a "relational" contract does not have an agreed single definition. One of the foremost proponents of relational contract theory, the late Professor Ian Macneil, was himself rather circumspect in describing relational contracts and the features identifying them. He ventured, however, that they were characterized

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<sup>56</sup> *Overlook Mgmt BV v Foxtel Mgmt Pty Ltd* [2002] NSWSC 17 [65], [67] (Austl.) (citation omitted) (quoting *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 450 (Austl.)).

<sup>57</sup> [2010] EWHC (TCC) 1632 [90] (Eng.).

by “whole person relations, relatively deep and extensive communication by a variety of modes, and significant elements of noneconomic personal satisfaction,”<sup>58</sup> whilst noting that these were not the only features which distinguished contractual relations from what he styled contractual transactions (an example given by him of the latter being a one-off purchase of gasoline at a service station<sup>59</sup>). Some long-term commercial relations may involve significant elements of noneconomic personal satisfaction (for instance, the employment relationship), but it is unlikely that *all* long-term relationships will do so (a point reinforced by some of the decisions mentioned below).

Turning to judicial usages of the language of relational contracts, in *Yam Seng*, Justice Leggatt distinguished contracts involving “a simple exchange” from those involving “a longer term relationship between the parties [in] which they make a substantial commitment.”<sup>60</sup> A long-term relationship manifesting substantial mutual commitment was thus identified as the crucial feature. In *Acer Investment Management Ltd. v. The Mansion Group Ltd.*,<sup>61</sup> which concerned an agreement between distributors of financial products and independent financial advisers,<sup>62</sup> the judge held that the contractual arrangements were *not* relational, citing the fact that “[i]t was not a long-term relationship: either party could end it by giving a relatively short period of notice” and that “[n]either party was required to spend significant sums in reliance on the continuation of the relationship.”<sup>63</sup> In those circumstances, he refused to imply a duty of good faith into the contract.<sup>64</sup> The analysis here is not entirely persuasive: the ability to end a contract by giving a short period of contractual notice is not necessarily inconsistent with a long-term relationship, albeit that one would tend to expect a more extended termination period. Nonetheless, the length of the relationship (and hence of party commitment to it) was clearly significant in the judge’s mind, as it had been in Macneil’s writing.

The need for ongoing communication and cooperation during the term of the contract would tend to indicate the existence of a relational contract; on that basis, a simple hire of goods is not likely to be

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<sup>58</sup> Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691, 723 (1974).

<sup>59</sup> *Id.* at 720.

<sup>60</sup> *Yam Seng* [2013] EWHC (QB) 111 [142].

<sup>61</sup> [2014] EWHC (QB) 3011 (Eng.).

<sup>62</sup> *Id.* [1]. The term argued for was “that the parties would deal with each other in good faith.” *Id.* [101]; *see also id.* [2], [86].

<sup>63</sup> *Id.* [107], [109].

<sup>64</sup> *Id.* [109].

relational, even though the hire may be for a number of years. In the recent case of *National Private Air Transport Services Co. v. Credit-trade Llp*,<sup>65</sup> the judge thought that a contract for the hire of aircraft was not a relational contract within the meaning of the term set out in *Yam Seng*, and consequently refused to imply an argued-for good faith based term.<sup>66</sup>

What difference does a relational contract make to what is likely to be implied? It seems that the duties which can be implied are likely to be more onerous, more proactive in what they require, and more cooperative in nature. The requirement to venture information to the other party (rather than just not to mislead by what is said) may be consistent with such a contract: Justice Leggatt suggests so in *Yam Seng*,<sup>67</sup> and the Scottish courts have in a similar vein been willing to imply duties to provide information in appropriate cases.<sup>68</sup> What other sorts of duties might be consistent with a relational contract? Might, perhaps, there be a duty on each party to report misconduct by a third party with whom one or both parties have a relationship, if such misconduct comes to the attention of either of them? Such a duty can arise within the context of an insurance contract,<sup>69</sup> but conceivably, a long-term relational contract might also create circumstances giving rise to such an implied duty.

As a matter of interest for an American audience, it may be worth adding that dealing with the adjustments that may be needed to allow a contract to adapt to changed circumstances is easier in one respect in Scotland than in most common law systems. The sort of adjustment this Essay envisions is where, in changed economic circumstances, one of the parties asks for an element of the contract to be changed in its favor, and the other simply agrees (perhaps because it favors the long-term continuance of the contract over short-term gain on its part). In the common law, this can be problematic: if A's duties are reduced, or its rights increased—without any consideration being given for this improvement to its position—this agreement may not be enforceable, at least not without some conceptual sleight of hand (such as the “practical benefit” ground advanced in the English

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<sup>65</sup> [2016] EWHC (Comm) 2144 (Eng.).

<sup>66</sup> *Id.* [136]–[137].

<sup>67</sup> *Yam Seng Pte. v. Int'l Trade Corp.* [2013] EWHC (QB) 111 [142] (Leggatt J) (Eng.).

<sup>68</sup> See generally, e.g., *Acotec UK Ltd. v. McLaughlin & Harvey Ltd.* [2016] CSOH 134 (Scot.); *Scottish Power plc v. Kvaerner Constr. (Regions) Ltd.* (1999) SLT 721 (Scot.).

<sup>69</sup> See *Banque Financière de la Cité S.A. v. Westgate Ins. Co.* [1991] 2 AC 249 (HL) at 251 (appeal taken from Eng.).

case of *Williams v. Roffey Bros. & Nicholls (Contractors) Ltd.*<sup>70</sup>). In systems like Scotland's that lack a requirement of contractual consideration, there is no problem with enforcing such contractual alterations: if parties agree to change a contract, that is the end of the matter, and the courts will give effect to their altered agreement. There is no need in such cases to call upon special circumstances pertaining to relational contracts, or to seek to construct some idea of consideration out of practical benefit, or to search for good faith based implied terms, in order to reach the intended result; it is just a matter of respecting the will of the parties and enforcing the amended agreement. So, fundamental doctrinal positions (like that in relation to the need for consideration) can render recourse to relational contractual solutions necessary or obsolete, depending on the position taken.

## 2. Long-Term vs. Short-Term Contracts

Post *Yam Seng*, there have been other reported cases of long-term, relational contracts into which courts have implied duties of good faith, such as *Bristol Groundschool Ltd. v. Intelligent Data Capture Ltd.*,<sup>71</sup> which concerned a long-term contract for the supply of materials for use in training airline pilots.<sup>72</sup> There is a contrast with cases of interim contracts: in one case involving a preliminary contract, the court did not find it appropriate to assume that the parties intended to include a suggested implied term concerning good faith directed to the conduct of a potential long-term joint venture between them.<sup>73</sup>

But the lengthy nature of a contract is not a guarantee that a court will always agree to the implication of a good faith based term. In *Carewatch Care Services Ltd. v. Focus Caring Services Ltd.*,<sup>74</sup> which concerned long-term franchising contracts,<sup>75</sup> the judge was not convinced that the terms argued for (the good faith term was one of seven alleged implied terms) were necessary for the agreement "to work commercially" (a remark framed with obvious reference to the busi-

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<sup>70</sup> [1991] 1 QB 1 (CA) at 11 (Eng.).

<sup>71</sup> [2014] EWHC (Ch) 2145 (Eng.).

<sup>72</sup> *Id.* [16].

<sup>73</sup> *Hamsard 3147 Ltd. v. Boots UK Ltd.* [2013] EWHC (Pat) 3251 [84] (Eng.).

<sup>74</sup> [2014] EWHC (Ch) 2313 (Eng.).

<sup>75</sup> *See id.* [10]. The term argued for was that "the parties would conduct themselves as franchisor and franchisee in good faith and/or dealing with each other fairly and in particular not in a manner that would damage each other's business interests." *Id.* [101].

ness efficacy test for implying terms).<sup>76</sup> On the view taken in this case, the fact that the parties are in a long-term contract is not by itself sufficient to justify implication of a good faith based term—something more is needed.

### 3. *Good Faith and the Right to Terminate: Monde Petroleum S.A. v. WesternZagros Ltd.*

In relation to the implication of terms requiring adherence to good faith, do we need to distinguish obligations to perform from remedial entitlements? In particular, is it easier to deploy good faith in the former category than in the latter? One recent case suggests so, at least so far as remedial entitlements, which are nondiscretionary in nature, are concerned.

In *Monde Petroleum S.A. v. WesternZagros Ltd.*<sup>77</sup> the claimant argued that its agreement to terminate a consultancy agreement between the parties was obtained by misrepresentation and/or economic duress.<sup>78</sup> One of the issues was whether it was an implied term of the contract that the defendant would not exercise any right to terminate in bad faith or in any manner which unconscionably deprived the claimant of its accrued or future rights.<sup>79</sup> The claimant argued that such implication was necessitated by business efficacy (and/or by “operation of law”), citing a number of factors in support of this argument.<sup>80</sup>

<sup>76</sup> *Id.* [109].

<sup>77</sup> [2016] EWHC (Comm) 1472 (Salter DJ) (Eng.).

<sup>78</sup> *Id.* [8].

<sup>79</sup> *Id.* [242]. The precise terms alleged to be implied into the contract (referred to in the judgment as the “CSA”) were as follows:

(a) each of the parties would act in good faith towards the other in the exercise of all of its rights and in performance of all of its obligations under the [CSA] generally, and in particular to give effect to the long-term, quasi-partnership nature of the parties business relationship; and/or . . . .

. . . .

(c) [WZL]’s right to terminate the [CSA] (under clauses 10.2 and/or 10.3 thereof) would not be, and could not be, exercised other than in good faith and/or in a manner which unconscionably deprived and [sic] Monde of its accrued and/or future rights arising under the [CSA]; and/or

(d) [WZL]’s right to terminate the [CSA] (under clauses 10.2 and/or 10.3 thereof) would only be exercised for the proper purpose for which it was conferred and not arbitrarily, capriciously or unreasonably (taking into account, inter-alia, Monde’s rights under and interests in the [CSA][)].

*Id.*

<sup>80</sup> *Id.* These included:

(a) the close working relationship of mutual trust and confidence between the parties;

The deputy judge (Richard Salter Q.C.) rejected the argument for implication, taking the view that nothing indicated that the contract would lack commercial or practical coherence without the implication of the argued for good faith term.<sup>81</sup> His view was that the contract did “not contain the sorts of mutual obligations and commitments that would be expected in the kind of relational contract” described by Justice Leggatt in *Yam Seng*.<sup>82</sup> Of specific relevance for the present discussion, he added that a further “insuperable objection” to the alleged implication was that the suggested term was concerned not with performance but termination, commenting that “a contractual right to terminate is a right which may be exercised irrespective of the exercising party’s reasons for doing so”<sup>83</sup>—in other words, as an act not involving any discretion. In support of this view, the judge cited a 2012 opinion of the Court of Appeal to that effect<sup>84</sup> as well as a number of other authorities.<sup>85</sup> The judge commented on this matter: “Contractual discretions arise where there are a range of options from which to choose. A contractual right to terminate involves a binary choice.”<sup>86</sup> The choice in this case as to whether to terminate was a “binary choice . . . constrained only by the objective contractual requirements which limit the circumstances in which that choice can be made.”<sup>87</sup> Even had the choice involved a subjective element, the judge would not have been persuaded by the need to impose a good faith limitation on it: “All contractual rights involve a choice. It is no more neces-

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(b) the stated common intention of the parties that the [CSA] should be a long-term co-operation . . . ;

(c) the quasi-partnership nature of the [CSA] . . . ;

(d) the common intention of the parties that the [CSA] should be for the mutual benefit of both [parties] . . . .

*Id.*

<sup>81</sup> *Id.* [255].

<sup>82</sup> *Id.* [259] (citing *Yam Seng Pte. v. Int’l Trade Corp.* [2013] EWHC (QB) 111 [142] (Leggatt J) (Eng.)).

<sup>83</sup> *Id.* [260]–[261].

<sup>84</sup> *Id.* [262] (“The right to terminate is no more an exercise of discretion, which is not to be exercised in an arbitrary or capricious (or perhaps unreasonable) manner, than the right to accept repudiatory conduct as a repudiation of a contract.” (quoting *Lomas v. JFB Firth Rixson Inc.* [2012] EWCA (Civ) 419 [46] (Lord Longmore LJ) (appeal taken from EWHC (Comm)) (Eng.))).

<sup>85</sup> *Id.* [263] (citing *Reda v. Flag Ltd.* [2002] UKPC 38 [42]–[43] (appeal taken from Berm.); *Hamsard 3147 Ltd. v. Boots UK Ltd.* [2013] EWHC (Pat) 3251 [82]–[88]; *TSG Bldg. Servs. PLC v. S. Anglia Hous. Ltd.* [2013] EWHC (TCC) 1151 [43]–[51]; *Greenclose Ltd. v. Nat’l Westminster Bank PLC* [2014] EWHC (Ch) 1156 [144]–[154]).

<sup>86</sup> *Id.* [266] (footnote omitted); *see also* *Myers v. Kestrel Acquisitions Ltd.* [2015] EWHC (Ch) 916 [61].

<sup>87</sup> *Monde Petroleum* [2016] EWHC (Comm) 1472 [271.1].

sary to imply a limitation upon the power to assess whether the contractual circumstances in which that choice may be made have occurred than it is to imply a limitation upon the choice itself.”<sup>88</sup>

The circumstances were not thus (so Judge Salter thought) analogous to those in *Socimer International Bank Ltd. v. Standard Bank London Ltd.*,<sup>89</sup> where Lord Justice Rix had considered that a discretion given to one party had to be exercised honestly and in good faith.<sup>90</sup> That was a decision which forms part of a consistent line of authority that where a discretionary power is conferred upon a party, there is to be implied a term that it must be exercised honestly and in good faith for the purpose for which it was conferred, and not exercised arbitrarily, capriciously, or unreasonably.<sup>91</sup> Summing up his view on the distinction between terms concerning performance and termination, Judge Salter said:

[T]he right to end a contract is different in kind to the sort of rights which may arise in the course of that contract’s performance. The purpose of a contractual right to terminate is to give the party on whom that right is conferred the power to bring the contract to an end. It is a right to bring an end to the parties’ shared endeavour. In my judgment, it is unlikely that the hypothetical reasonable commercial man or woman would expect the party exercising that right to be obliged to consult anyone’s interests but its own.<sup>92</sup>

What can be said about the judgment in *Monde*, and in particular of the judge’s view of good faith constraints on a right to terminate a contract? First, whatever one’s views on the desirability of the outcome, the underlying spirit of the judgment does appear to be at odds with that expressed in *Socimer*. In *Socimer*, the court noted that commercial contracts presuppose the operation of good faith: “Commercial contracts assume such good faith, which is why express language requiring it is so rare.”<sup>93</sup> By contrast, in *Monde* the judge began by

<sup>88</sup> *Id.* [271.2].

<sup>89</sup> [2008] EWCA (Civ) 116 (appeal taken from EWHC (Comm)) (Eng.).

<sup>90</sup> *See id.* [62].

<sup>91</sup> *See id.* (citing *Ludgate Ins. Co. v. Citibank NA* [1998] EWHC (Comm) 1144 [35]); *see also* *British Telecomm. Plc v. Telefónica O2 UK Ltd.* [2014] UKSC 42 [37]–[38], [43] (appeal taken from Eng.); *Keen v. Commerzbank AG* [2006] EWCA (Civ) 1536 [52], [67]; *Cantor Fitzgerald Int’l v. Horkulak* [2004] EWCA (Civ) 1287 [37]–[38], [43]; *Paragon Fin. plc v. Nash* [2001] EWCA (Civ) 1466 [25]; *Abu Dhabi Nat’l Tanker Co. v. Prod. Star Shipping Ltd.* [1993] 1 Lloyd’s Rep. 397 (CA) at 404; *Clark v. Nomura Int’l plc* [2000] 29 IRLR 766 (EWHC (QB)) [40]; *Brogden v. Investec Bank Plc* [2014] EWHC (Comm.) 2785 [91], [94], [100].

<sup>92</sup> *Monde Petroleum* [2016] EWHC (Comm) 1472 [272].

<sup>93</sup> *Socimer* [2008] EWCA 116 [116].

stating that “[t]here is no general doctrine of ‘good faith’ in English contract law,” rather a duty of good faith is implied by law only “as an incident of certain categories of contract.”<sup>94</sup> The English bench still seems to harbor a difference of opinion in relation to the desirability of recognizing a general doctrine of good faith.

Second, what of the view that a right to terminate does not involve discretion, and of the view that parties would not expect it to be exercisable by reference to any interests except those of the party having the right? The author is not personally persuaded that a binary choice necessarily precludes the operation of discretion. The identification of the number of choices available does not fully address the element of discretion; rather, one needs to ask of a potential decision facing a contracting party whether (1) any objectively ascertainable conditions required to be met before the decision may be exercised have been met—preeminently in termination cases, whether a sufficiently serious breach of contract has occurred; and (2) thereafter, what further conditions (if any) constrain the innocent party’s decisionmaking process. There may be none, but the contract may have specified some further conditions as applicable to the decision whether to terminate, e.g., that the decision must be made “reasonably” or “not arbitrarily.” Such conditions do not arise when exercising the default, common law right to terminate for breach, but they may form part of a contractually defined right to terminate. It therefore seems too blunt to assert that, in every contract, the right to terminate may not involve the exercise of a discretion; in some cases, it might conceivably do so.

In the absence of additional conditions affecting the right to terminate, however, may a party be given an apparently absolute, unrestrained power to decide whether to terminate with regard purely to its own interests, or might it be required to some extent to consider the interests of the other party as well? *Monde* suggests the former. This is consistent with the traditional common law approach, and hence is arguably consistent with the expectation of English contracting parties (as the judge suggests), at least for the present. But if good faith arguments are presented to courts with increasing frequency, it may be questioned for how much longer such decisions will continue to be consistent with parties’ expectations. There is of course also the point that the objective requirement (in Scots law at least)

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<sup>94</sup> *Monde Petroleum* [2016] EWHC (Comm) 1472 [249] (citing the equally skeptical view of Lord Justice Jackson in *Mid Essex Hospital Services NHS Trust v. Compass Group UK & Ireland Ltd.*).

that a breach must be material before the right to terminate arises can be seen as a built-in good faith restraint on the right to terminate, albeit a restraint which takes into account only the severity of the breach rather than the specific circumstances and interests of the party in breach.<sup>95</sup>

If *Monde* is correct, then what it suggests ought to be applicable to other “non-discretionary” remedies, such as the justified right to withhold performance in relation to the other party’s breach of contract (what is called retention in Scots law, or in civilian systems the *exceptio non adimpleti contractus*).<sup>96</sup> Of course, as with the need to show that a breach is material before termination can occur, what are arguably good faith based limitations can be built into the rules governing such other remedies. Thus, in Scots law, there is a rule that only nontrivial breaches of contract by one party entitle the other to withhold performance.<sup>97</sup> This ensures that the self-help remedy is not used in a way that is out of proportion to the other party’s breach—attempting to do so would, it might be said, be a failure to “behave decently.” Note though that in this case, it is a rule of contract law rather than an implied term, which does the work of exercising restraint on the parties’ free will. Note also that because the common law remedy of retention can be excluded in Scotland—entitling the parties to provide for their own scheme of justified withholding—a question arises whether, in any such agreed scheme, it might be possible to argue for a good faith based break on the agreed right to withhold. On the approach taken in *Monde*, the likely answer would be no.

#### 4. Other Good Faith Jurisprudence

In two further first instance English judgments handed down in 2016, the courts took an unfavorable view towards alleged good faith based implied terms.

In *Apollo Window Blinds Ltd. v. McNeil*,<sup>98</sup> the Queen’s Bench refused to accede to a suggestion that a term be implied into a contract requiring one party, in good faith, to inform the other party of its contractual rights<sup>99</sup> (arguably, an entirely sensible view). There is an obvious contrast with the established duty in English law resting on

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<sup>95</sup> See *Inveresk plc v. Tullis Russell Papermakers Ltd.* [2010] UKSC 19 [43] (appeal taken from Scot.).

<sup>96</sup> See *id.* [36].

<sup>97</sup> See *id.* [43].

<sup>98</sup> [2016] EWHC (QB) 2307.

<sup>99</sup> *Id.* [23].

contracting parties to point out to their intended contracting partners at the negotiating stage any exceptionally onerous terms<sup>100</sup>: in such cases, the contract has not yet been formed, and the matter in question is a potentially onerous duty and not a right. In the second case, *Hockin v. Royal Bank of Scotland plc*,<sup>101</sup> the High Court was unwilling to imply a term that a party must act in good faith in performing the terms of an agreement (specifically, it was alleged that in exercising any discretionary power, the bank should act in “good faith and not arbitrarily or capriciously”)<sup>102</sup> because the judge felt that there was insufficient evidence about the “relevant factual matrix” of the parties’ relationship (specifically, evidence about the “factual complexity of the relationship of the relevant individuals before the execution of the [agreement]”)<sup>103</sup> for the court to be able to determine whether the term should be implied.<sup>104</sup>

The comments of the judge in *Hockin* are a useful example of not only the crucial nature of the context of the parties’ relationship to the question of implication of any good faith based term but also of the need to plead such elements explicitly. They reinforce what was said in 2015 in *D&G Cars Ltd. v. Essex Police Authority*<sup>105</sup>: “both the existence and the content of an implied condition in relation to honesty and integrity is highly sensitive to the context of the contract itself.”<sup>106</sup> In stressing the importance of pleading the specifics of the context, *Hockin* and *D&G Cars* follow the lead taken by *Yam Seng*<sup>107</sup> and *Mid Essex Hospital*.<sup>108</sup>

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<sup>100</sup> See *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.* [1989] 1 QB 433 (CA) at 438–39 (Lord Dillon LJ) (appeal taken from Lambeth Cty. Ct.) (Eng.) (citing *Thornton v. Shoe Lane Parking Ltd.* [1971] 2 QB (CA) 163 at 172); see also *id.* at 439 (Lord Bingham LJ).

<sup>101</sup> [2016] EWHC (Ch) 925 (Eng.).

<sup>102</sup> *Id.* [11].

<sup>103</sup> *Id.* [47].

<sup>104</sup> *Id.*

<sup>105</sup> [2015] EWHC (QB) 226 (Eng.).

<sup>106</sup> *Id.* [175].

<sup>107</sup> What good faith requires is sensitive to context. . . . “[R]elational” 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.

*Yam Seng Pte. v. Int’l Trade Corp.* [2013] EWHC (QB) 111 [141]–[142] (Eng.) (Leggatt J).

<sup>108</sup> *Mid Essex Hosp. Servs. NSH Tr. v. Compass Grp. UK & Ir. Ltd.* [2013] EWCA (Civ) 200 [109] (Lord Jackson LJ) (appeal taken from EWHC (QB)); see also *id.* [150] (Lord Beatson LJ) (quoting the “sensitive to context” remark made by Justice Leggatt in *Yam Seng*).

Duties to negotiate (or renegotiate) bring with them special difficulties, as negotiation is an inherently uncertain process and may not lead to any concluded outcome. How is a court to judge if a party has failed to negotiate in good faith?<sup>109</sup> Given this, courts typically have not been inclined to enforce such duties *unless* they are (1) constituted by an express term imposing the duty within a long-term contractual relationship, and (2) there is a clear mechanism for judging the conformity of the parties' negotiating efforts with a contractually stipulated process for negotiation. An example of a case where such a duty *was* enforced is the Scottish appeal level judgment in *G4S Cash Centres (UK) Ltd. v. Clydesdale Bank plc*.<sup>110</sup> The parties were "in dispute as to the construction to be placed on provisions of a contract whereby [G4S was] to supply [a cash processing service] to the [Bank], the provisions in question relating to the consideration to be paid to the [Bank] for those services."<sup>111</sup> The contract contained a mechanism designed to allow the price payable to G4S to be renegotiated.<sup>112</sup> The clause concerning the renegotiation process obliged the parties to "negotiate in good faith to agree such Services Fees" and continued that "any dispute shall be resolved in accordance with clause 12."<sup>113</sup> The appeal court held the duty to negotiate in good faith to be enforceable, commenting:

The agreement does not, in our view, produce simply an agreement to agree or an agreement so uncertain as to be unenforceable. . . . The misconception in the [Bank's] submission on this topic is that it fails to recognise that although consensus in idem is required before a contract can come into existence between the parties, it does not follow that there is simply an agreement to agree, in a contract designed to endure for some time, while there remains to be agreed something which affects the contractual relationship. For parties in a commercial, long running, contract to leave matters

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<sup>109</sup> A type of duty bearing some similarity to a duty to negotiate in good faith is a duty to use "best endeavors" or "reasonable endeavors" to agree a matter, often a price. For a case involving such a duty see, for instance, *R&D Construction Group Ltd. v. Hallam Land Management Ltd.* [2009] CSOH 128 [48]–[49] (Scot.), in which the court upheld a duty on a party to "use all reasonable endeavours" to agree on a purchase price of land. Lord Hodge took the view that there was no "insuperable obstacle which would prevent the courts from reaching a view as to the means of achieving that object and deciding whether Hallam had used all reasonable endeavours to agree the price." *Id.* [49].

<sup>110</sup> [2011] CSIH 48 (Scot.).

<sup>111</sup> *Id.* [1].

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* [6].

on such a footing is not “inherently improbable” but is commonplace in complex contractual arrangements intended to endure for substantial periods of time during changing circumstances.<sup>114</sup>

The long-term, contextual nature of the parties’ relationships was clearly crucial to the court’s finding in this case, as was the fact that the expressly provided for renegotiation process was to be regulated by the provisions of a clause of the contract. Without such a process by which to judge the negotiations, it might have been more difficult to convince the court that the duty to renegotiate in good faith was not inherently ambiguous (and a mere “agreement to agree”).<sup>115</sup> There may, however, be something of a redundancy in the approach to good faith in such cases: if parties are to negotiate in good faith, but failures to agree are to be resolved by reference to a procedure (often arbitration by a third party), the good faith element requirement seems redundant. If parties can’t agree, they simply get a third party to determine the outcome, thereby effectively rendering the preceding negotiations redundant. But perhaps that doesn’t matter—showing good faith along the way is what counts to a relationship based on trust, even if acting in good faith does not resolve the dispute.

Without any express duty to renegotiate a specified matter in a contract, courts will not imply a duty to undertake such renegotiation in good faith. Contracts can work without price renegotiation, even if at one extreme the price becomes arduous on one party, or at the other it ceases to bring meaningful income to the other party.<sup>116</sup> Requiring good faith renegotiation of a price, even in a long-term relational contract, would undermine the recently expressed view of the Supreme Court that there is no doctrine of equitable adjustment of contracts in Scots law.<sup>117</sup> At the pre-formation stage, the firm view of the House of Lords expressed in *Walford v. Miles*<sup>118</sup> was that courts will not imply a term into a preliminary contract requiring good faith

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<sup>114</sup> *Id.* [16] (citation omitted).

<sup>115</sup> In *Barbudev v. Eurocom Cable Management Bulgaria EOOD* [2012] EWCA (Civ) 548 [43], [44] (appeal taken from EWHC (Comm)) (Eng.), where one party had offered the other “the opportunity to invest . . . on the terms to be agreed between us which shall be set out in the Investment Agreement and we agree to negotiate the Investment Agreement in good faith with you,” the court took the view that this gave rise to only a nonbinding “agreement to agree,” and not a binding contract.

<sup>116</sup> See *Arnold v. Britton* [2015] UKSC 36 [10], [2015] AC 1619 at 1626 (appeal taken from Eng.).

<sup>117</sup> *Lloyds TSB Found. for Scot. v. Lloyds Banking Grp. plc* [2013] UKSC 3 [37] (Lord Hope DP) (appeal taken from Scot.).

<sup>118</sup> [1992] 2 AC 128 (HL) (appeal taken from Eng.).

negotiation of an intended longer-term contract, as such a term would be “inherently repugnant to the adversarial position of the parties”<sup>119</sup> (a description which is clearly a long way from the cooperative dimension of the idea of good faith).

### 5. *An Issue in Need of Exploration*

An interesting question is the extent to which an implied good faith based duty might be excluded by an express term in the parties' contract. Where a good faith requirement derives from a statutory rule, it is usually the case that the rule cannot be excluded—as is the case, for instance, with the good faith performance duty under the UCC<sup>120</sup> or the unfair terms rule of the U.K. Consumer Rights Act 2015.<sup>121</sup> In some contexts, the parties may be entitled to determine the level of good faith performance, subject to a control excluding the specification of an unreasonable standard.<sup>122</sup> Nonstatutory rules of the common law which can be said to manifest aspects of good faith can often be excluded by the parties: for instance, default rules on justified withholding of performance can be excluded. But are default rules expressly based on good faith to be treated differently? And does it make a difference if the duty derives from such a default rule as opposed to a so-called implied term?

Where a good faith requirement is the subject only of a possible common law implied term, in theory, it should be possible to exclude it: express terms trump implied terms. The validity of such a term could be defended as an expression of freedom of contract, even if it might be highly unusual and unlikely for one party expressly to declare that it was entitled to perform its obligations or enforce its remedies in a manner inconsistent with good faith (such a course of action would hardly be a good selling point for the party advancing the exclusionary term).

There might be cases where the relationship between the parties is one of such dependency by one party on the other that the resulting trust reposed in the stronger party necessarily creates a relationship of inherent good faith. An attempted express exclusion of good faith in such a relationship could be said to be nonsensical, and a court faced

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<sup>119</sup> *Id.* at 138.

<sup>120</sup> See U.C.C. § 1-302(b) (AM. LAW INST. & UNIF. LAW COMM'N 2014) (“The obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement.”).

<sup>121</sup> Consumer Rights Act 2015, c. 15, § 62, sch. 2 (UK).

<sup>122</sup> See U.C.C. § 1-302(b) (entitling the parties to determine the standard of good faith performance so long as such standard is not “manifestly unreasonable”).

with such a clause might perhaps attempt to interpret it against the natural meaning of its wording. Even where it is not specifically good faith which is excluded, but (as more commonly happens) the liability of one party to the other for some loss, a court may feel that such exclusion is not consistent with the good faith nature of the parties' relationship. A good example of this is the case of *HIH Casualty & General Insurance Ltd. v. Chase Manhattan Bank*,<sup>123</sup> in which the House of Lords held that an *ex facie* blanket exclusion of liability by one party was not to be interpreted as excluding liability for its deceit.<sup>124</sup> Lord Bingham, explaining their Lordships' view, remarked that "[p]arties entering into a commercial contract . . . will assume the honesty and good faith of the other; absent such an assumption they would not deal."<sup>125</sup>

Apart from cases of inherent good faith deriving from the nature of the relationship, such as *HIH Casualty*, might express exclusions of implied good faith terms be successful? It seems that attempts deriving from an express term excluding *all* implied terms (an "entire agreement" clause) are less likely to be viewed favorably by courts. Of note are three cases involving such clauses. In the English case of *Mid Essex Hospital Services NHS Trust v. Compass Group UK & Ireland Ltd.*,<sup>126</sup> Lord Justice Jackson expressed the view that the implied duty to exercise a contractual discretion in a fashion which is not "arbitrary, capricious or irrational" would be "extremely difficult to exclude, although I would not say it is utterly impossible to do so" (the "although . . . ." being an important rider).<sup>127</sup> In a more prescriptive manner, the Supreme Court of Canada remarked that "[b]ecause the duty of honesty in contractual performance is a general doctrine of contract law that applies to all contracts, like unconscionability, the parties are not free to exclude it."<sup>128</sup> It is interesting that the invalidity in this case was linked to a duty said to rest upon a "general doctrine" and not an implied term.<sup>129</sup> In its decision, the Canadian court referred approvingly to the third case, an earlier judgment of the Australian Federal Court, *GEC Marconi Systems Pty. v. BHP Information Tech-*

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<sup>123</sup> [2003] UKHL 6 (appeal taken from Eng.).

<sup>124</sup> *Id.* [16].

<sup>125</sup> *Id.* [15].

<sup>126</sup> [2013] EWCA (Civ) 200 (Lord Jackson LJ) (appeal taken from EWHC (QB)) (Eng.).

<sup>127</sup> *Id.* [83].

<sup>128</sup> *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 S.C.R. 494 [75] (Can.) (citation omitted).

<sup>129</sup> *See id.*

*nology Pty.*,<sup>130</sup> in which Justice Finn had remarked, “I find arresting the suggestion that an entire agreement clause is of itself sufficient to constitute an ‘express exclusion’ of an implied duty of good faith and fair dealing where that implication would otherwise have been made by law.”<sup>131</sup> The preponderance of opinion is that entire agreement clauses will not exclude implied duties of good faith, this suggesting that a targeted exclusion might be successful. But there is some uncertainty, as seen in Lord Justice Jackson’s rider.<sup>132</sup>

Further judicial examination of the preferable approach to the purported exclusion of implied good faith duties would be welcome. In particular, it would be helpful to see attention paid to two issues: (1) whether targeted exclusions of good faith implied terms are any more likely to be successful than generalized “entire agreement” exclusions; and (2) whether it makes a difference that good faith is described by a legal system as an implied term as opposed to an underlying doctrine or rule of contract law—the suspicion being that in the latter instance, exclusion will be harder, if not impossible.

### CONCLUSION

Typically, British courts have conceived of good faith in broad brush terms. Specifically, the courts have identified honesty, openness, loyalty/fidelity, and mutual trust and confidence as the elements of the principle of good faith. Good faith ideas can be manifested in contract terms which do not explicitly use the term good faith but nonetheless act as substantive equivalents.<sup>133</sup> Theoretically, good faith might be used either as a reason for implying a term, procedural good faith, or else to fashion the content of an implied-in-fact term, so that a party is required to conduct itself in good faith, substantive good faith.<sup>134</sup>

In practice, there is no support for using good faith as a gateway for implying a term in United Kingdom jurisprudence. The traditional tests for implication—“business efficacy” and “officious bystander”—place a higher hurdle (necessity) in the way of implication than does good faith, with its connotations of reasonableness and equity. Furthermore, because good faith does not characterize all contractual re-

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<sup>130</sup> *Id.* [78] (citing *GEC Marconi Sys. Pty. v BHP Info. Tech. Pty.* [2003] FCA 50, 264 (Finn J) (Austl.)).

<sup>131</sup> *GEC Marconi Systems* [2003] FCA 50 at 264.

<sup>132</sup> See *supra* text accompanying note 127.

<sup>133</sup> See *supra* notes 18–23 and accompanying text.

<sup>134</sup> See *supra* Part I.

lationships, good faith is, in general, neither a necessary nor sufficient reason for implying a term into a contract.<sup>135</sup>

In terms of substantive good faith, good faith does *not* require an absolute subservience of the interests of one party to those of another. Terms embodying substantive good faith are more likely to be implied into relational contracts, but the mere fact that a contract endures over time is not of itself sufficient to justify such implication. Any suggested term must still be necessary to make the contract work, must be consistent with the expressly agreed terms, and must reflect the underlying though unexpressed intentions of the parties.<sup>136</sup>

The remedy of contract termination has been thought not to be susceptible to good faith regulation, given its binary nature (see the *Monde Petroleum* case). It has been suggested, however, that a binary choice does not necessarily preclude the operation of discretion. The number of choices is not the issue; rather, at issue is whether (1) any objectively ascertainable conditions that must be fulfilled before the decision may be exercised have been met; and (2) thereafter, what further conditions (if any) constrain the decisionmaking process. Such further conditions could involve discretion, but no such restraining conditions exist in relation to the default common law right to terminate (save that the breach must be material, which could be seen as an inbuilt good faith restraint).<sup>137</sup>

It is crucial to plead the specific context of parties' relationships in order to justify implication of a good faith based term. Without an express duty to renegotiate a specified matter in a contract, British courts will not imply a duty to undertake such renegotiation in good faith.<sup>138</sup> Exclusion of good faith implied common law terms should in theory be possible, at least in some cases. However, the specific context may render such an exclusion nonsensical. Moreover, courts have not been well disposed to attempts to exclude implied good faith via "entire contracts" clauses.<sup>139</sup>

Some of the requirements of substantive good faith could be written into the law as rules rather than as implied terms. In conceivably developing such an approach, however, careful consideration would be required. While the application of common law rules can sometimes be excluded by the parties, the entrenching of a good faith based

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<sup>135</sup> See *supra* Part II.

<sup>136</sup> See *supra* Part III.

<sup>137</sup> See *supra* Section III.B.3.

<sup>138</sup> See *supra* Section III.B.4.

<sup>139</sup> See *supra* Section III.B.5.

rule would represent a deeper embedding of a good faith commitment within the legal system. Judicial commentary on the question of whether good faith should be seen as underlying *all* instances of contract, or rather (as this Essay argues) the presence or absence of a good faith relationship, is a matter of fact to be judged in each case, would be welcome.