

TANFIELD

Good Faith Clauses in Development Agreements

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Introduction

1. In recent years it has become increasingly common for parties to a development agreement to agree to act towards one another with “good faith”. The meaning and extent of the obligations on the contracting parties imposed by such clauses is often difficult to ascertain. The purpose of this paper is to consider a number of cases in which good faith clauses, implied and express, are discussed and identify the general principles that apply to development agreements.

Good faith in English contract law

2. The courts have repeatedly held that there is no general doctrine of “good faith” in English contract law. In *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433 at 439 Bingham LJ said:

“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”. It is in essence a principle of fair open dealing ... English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.”

3. Three main reasons have been given for the hostility towards a doctrine of good faith. First, the preferred method of English law is to proceed incrementally by fashioning particular solutions in response to particular problems rather than by enforcing broad overarching principles. Second, English law is said to embody an ethos of individualism, whereby the parties are free to pursue their own self-interest not only in negotiating but also in performing contracts provided they do not act in breach of a term of the contract. Third, the fear that recognising a general requirement of good faith in the performance of contracts would create too much uncertainty: there is concern that the content of the obligation would be vague and subjective and that its adoption would undermine the objective of contractual certainty to which English law has always attached great weight.

What does “good faith” mean?

4. In *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd* [2001] UKHL 1, [2003] 1 AC 469 insurers alleged that shipowners had failed to observe “utmost good faith” (as required by s. 17 of the Marine Insurance Act 1906) in the presentation of a claim. The Commercial Court judge, the Court of Appeal and the House of Lords all rejected that defence. Their Lordships held that in the particular context the duty of utmost good faith required no more than that the insured should act honestly and not in bad faith.

5. In *HIH Casualty v Chase Manhattan Bank* [2003] UKHL 6 Lord Hoffman observed at [68] “parties contract with one another in the expectation of honest dealing ... in the absence of words which expressly refer to dishonesty, it goes without saying that underlying the contractual arrangements of the parties there will be a common assumption that the persons involved will behave honestly.”
6. Good faith, however, is wider than behaving honestly. It extends to the observance of “standards of commercial dealing which are so generally accepted that the contracting parties would reasonably be understood to take them as read without explicitly stating them in their contractual document”: see *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB) per Leggatt J at [139]. In that case Leggatt J continued: “Another aspect of good faith ... is what may be described as fidelity to the parties’ bargain. The central idea here is that contracts can never be complete in the sense of expressly providing for every event that may happen. To apply a contract to circumstances not specifically provided for, the language must accordingly be given a reasonable construction which promotes the values and purposes expressed or implicit in the contract.”

Express contractual duties of good faith in development agreements

7. The two aspects of good faith identified by Leggatt J are consistent with the way in which express contractual duties of good faith have been interpreted in two recent cases concerning development agreements.
8. In *Berkeley Community Villages Ltd v Pullen* [2007] EWHC 1330 (Ch), a property developer contracted with owners of land to use its expertise to maximise the potential for development of a substantial part of the land in

return for a fee payable in certain circumstances. The contract contained an express term that:

“[i]n all matters relating to this Agreement the parties will act with the utmost good faith towards one another and will act reasonably and prudently at all times.”

9. Although the developer made efforts to promote the owners' land (including towards obtaining a planning consent of considerable value), the owners wished to sell the land in question to a third party for a very large sum. The developer, which argued that the would-be sale price reflected the significant improvement in its planning prospects, applied for an injunction to prevent the owners from selling or otherwise disposing of the land. Morgan J held at [97] that, as a matter of construction, the express term imposed on the owners.

“... a contractual obligation to observe reasonable commercial standards of fair dealing in accordance with their actions which related to the Agreement and also [required] faithfulness to the agreed common purpose and consistency with the justified expectations of the [developer].”

10. In the circumstances, Morgan J considered that the intended sale would amount to breach of the owners' obligation of good faith on the grounds that: the developer had invested considerable time and incurred expense as a result of which the value of the land had been significantly enhanced; on the terms of the contract, the owner was not obliged to pay a reasonable fee to the developer on the sale; in any event, the developer's expectations were that they would promote the land to obtaining planning consent and sale in the open market (whereupon they would be entitled to a fee under the express terms of the contract); the third party buyer would not be bound by the terms of the contract; and, finally, the owner put forward no extenuating circumstances or hardship.

11. In *CPC Group Ltd v Qatari Diar Real Estate Investment Co* [2010] EWHC 1535 (Ch) the parties entered into a joint venture agreement to acquire

Chelsea Barracks with a view to its development. A sale and purchase agreement between the parties imposed an obligation upon both of them to act “in utmost good faith”. Vos J held at [246] that, having regard to the context, the content of this obligation was:

“to adhere to the spirit of the contract, which was to seek to obtain planning consent for the maximum Developable Area in the shortest possible time, and to observe reasonable commercial standards of fair dealing, and to be faithful to the agreed common purpose, and to act consistently with the justified expectations of the parties.”

12. While Vos J did not need “to decide whether this obligation could only be broken if [the defendant or the claimant] acted in bad faith”, he considered that “it might be hard to understand, as Lord Scott said in *Manifest Shipping*, how, without bad faith, there can be a breach of a ‘duty of good faith, utmost or otherwise’”. On the facts, however, he found that there had been no breach of the obligation of utmost good faith as so interpreted.

An implied duty of good faith?

13. Although there is no general doctrine of “good faith” in English contract law, a duty of good faith is implied by law as an incident of certain categories of contract, for example, contracts between partners to a joint venture or others whose relationship is characterised as a fiduciary one.
14. In the *Yam Seng* case Leggatt J saw no difficulty in implying a duty of good faith in any ordinary commercial contract based on the presumed intention of the parties. The process of implication of terms has been analysed as an exercise in the construction of the contract as a whole: see *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988. The relevant background includes not only matters of fact known to the parties but also shared values and norms of behaviour. A general norm

which underlies almost all contractual relationships is an expectation of honesty. It is difficult to identify circumstances in which, at the date of the contract, a reasonable person would consider the objective intention of the parties was anything other than to act in good faith. The argument has even great force in respect of contracts involving a longer term relationship and substantial commitment requiring a high degree of communication and cooperation based on mutual trust and confidence. Such contracts involve expectations of loyalty, which are not legislated for in the express terms of the contract, but are implicit in the parties' understanding and are necessary to give business efficacy to the arrangements. Development agreements are a classic example of such "relational contracts".

Limits to the duty to act in good faith

15. The *content* of a duty of good faith, however, depends heavily on its context. In *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (Trading As Medirest)* [2013] EWCA Civ 200, a contractor agreed to provide catering and cleaning services to two hospitals. The contract contained a mechanism whereby the trust could award "service failure points" from which it could calculate the appropriate payment deductions for the contractor's performance failures. The contract included the following term:

"The Trust and the Contractor will co-operate with each other in good faith and will take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable the Trust or, as the case may be, any Beneficiary to derive the full benefit of the Contract. At all times in the performance of the Services, the Contractor will co-operate fully with any other contractors appointed by the Trust or any Beneficiary in connection with other services at the Location."

16. At first instance, the judge held that “it accorded with commercial common sense for there to be a general obligation on both parties to co-operate in good faith” and that the Trust’s behaviour in awarding excessive service failure points constituted a breach of this obligation. The Court of Appeal disagreed, reversing the decision below. Jackson LJ held:

“the obligation to co-operate in good faith is not a general one which qualifies or reinforces all of the obligations on the parties in all situations where they interact. The obligation to co-operate in good faith is specifically focused upon the two purposes stated in the second half of the clause [namely: (i) the efficient transmission of information and instructions; and (ii) enabling the Trust or any beneficiary to derive the full benefit of the contract.]”

17. More recently, in *Sainsbury’s Supermarkets Limited v Bristol Rovers (1883) Limited* [2015] EWHC 2002 (Ch), Proudman J had to decide whether Sainsbury’s reliance on a specific provision in an agreement could amount to a breach of the duty to act in good faith. In that case, Sainsbury’s agreed to buy the club’s stadium with the intention of developing it as a supermarket. The agreement was subject to a number of conditions, including that Sainsbury’s obtained ‘Acceptable Store Planning Permission’. It was agreed that if certain conditions were not satisfied by the ‘Cut Off Date’ then either party might terminate the agreement. Sainsbury’s agreed to “use all reasonable endeavours to procure the grant of an Acceptable Store Planning Permission”. Clause 2.11 provided: “[Sainsbury’s] may in its absolute discretion pursue an Appeal against a Planning Refusal but shall be obliged to do so if: (a) Planning Counsel confirms that such an Appeal has a 60% chance or greater of achieving an Acceptable Store Planning Permission on or before the Long Stop Date”. Both parties agreed “to act in good faith in relation to their respective obligations in this Agreement and to assist the other in achieving Acceptable Planning Permission for the Store Development and the Stadium Development.” Planning permission was granted but with a condition limiting deliveries to the store to certain hours, the effect of which was that there was a deemed ‘Planning

Refusal'. Sainsbury's initial application to vary the condition was refused. Sainsbury's wanted to terminate the agreement if it lawfully could and so, thereafter, it refused to appeal or to withdraw and resubmit an application to vary the conditions on the grounds that Planning Counsel had determined that the prospects of success were not sufficient. The club argued that Sainsbury's reliance on the 'black letter' of clause 2.11 was a breach of the duty to act in good faith. Proudman J held that the duty to act in good faith did not mean that Sainsbury's was obliged to act contrary to a specific provision of the agreement.

Conclusions

18. Although English contract law recognises no general principle of good faith, it has become increasingly common for parties to a development agreement to agree to such clauses. In the absence of an express clause, it is now more likely that the courts will imply a duty to act in good faith, particularly where the parties have entered into a joint venture which is dependent upon co-operation between the parties. The content and scope of the duty of good faith depends on its context. Developers and landowners should not overlook the duty of good faith when taking decisions affecting a development agreement.

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