Development Disputes

Current issues for property litigators

‘Good Faith’ clauses in development agreements

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Introduction

Parties to a development agreement often include in their contract a clause requiring them to act towards one another with "good faith". To judge by the relative paucity of case law concerning such clauses, this is a recent development. Nonetheless, such clauses are now common. Four recent cases have brought a greater degree of clarity as to the meaning and effect of such clauses. The purpose of this article is to consider these cases and seek to draw together the principles generally applicable to such good faith clauses.

The lack of a general good faith principle

It is often said that English contract law recognises no general principle of good faith. In *Interfoto Picture Library v Stiletto Visual Programmes*,[1] Bingham LJ said: [2]

> *"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. Many examples could be given. Thus equity has intervened to strike down unconscionable bargains. Parliament has stepped in to regulate the imposition of exemption clauses and the form of certain hire-purchase agreements. The common law also has made its contribution, by holding that certain classes of contract require the utmost good faith, by treating as irrecoverable what purport to be agreed estimates of damage but are in truth a disguised penalty for breach, and in many other ways."*

The "piecemeal solutions" referred to by Bingham LJ are indeed many – so many that some question the absence of the general principle.[3] The piecemeal solutions include several that are of particular relevance to development agreements. These include: the principle of non-derogation from grant which is capable of preventing a vendor of land from using his retained land in such a way as to frustrate the purpose of the sale; the principle of law that a party shall not be permitted to take advantage of his own wrong; and the implication of a duty of mutual good faith between parties to a joint venture. [4]

Nevertheless, parties to development agreements appear increasingly to go beyond these piecemeal solutions by including in their contract an express clause requiring them to act towards one another with "good faith".

Before embarking upon a closer examination of the cases, it is worth pausing to consider the reasons why English law has traditionally set its face against any over-arching principle of good faith. Foremost among the reasons is the idea that a duty of good faith is contrary to the freedom enjoyed by contractual counter-parties to pursue their adversarial self-interest. In *Walford v Miles*[5] the House of Lords refused to enforce an agreement to negotiate on the grounds that it was too uncertain to

1 [1989] QB 433
2 At page 439
3 e.g. Harrison on Good Faith in Sales (Sweet & Maxwell; 1997) chapter 1.
4 See *Ross River Ltd v Cambridge City Football Club Ltd* [2008] 1 All ER 1004, and *Ross River v Waveley Commercial* [2012] EWHC 81 (Ch). For consideration of the former see Emer Murphy's article *"The changing face of overage"* elsewhere in this book.
5 [1992] 2 AC 128

be enforceable. In the course of his judgment Lord Ackner considered whether an agreement to negotiate in good faith would be sufficiently certain to have contractual force. He said:[6]

> *"… the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. … how is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an "agreement?" A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party."*

As we shall see, much of the difficulty in applying a contractual duty of good faith lies in the need to resolve the inherent tension between this legitimate pursuit of self interest and the requirement imposed by a duty of good faith to have proper and due regard for the interests of the other party.

Express contractual duty of good faith: four recent cases

The meaning and effect of an express contractual duty of good faith is a question of interpretation. The clause in question must be interpreted in the context of the agreement as a whole and against the relevant background matrix of fact. Axiomatically, it will depend upon all the circumstances of the given case. The principles applicable to interpreting such a clause are no different to those applicable in relation to any other question of contractual interpretation.

However, four recent cases, three of them in the context of development of land, have addressed directly the meaning and effect of good faith clauses. I will consider each of these before turning to see what conclusions we can draw from them as to the approach the Courts are likely to take.

***Berkeley Community Villages v Pullen*[7]**

In *Berkeley Community Villages v Pullen* a developer and a landowner entered an agreement to promote the inclusion of the landowner's agricultural land within the relevant local development plan for residential or mixed development. The developer agreed to act on a 'no win, no fee' basis, in return for 10% of the net returns upon a sale of the land, once planning permission for residential or mixed development had been obtained. The developer invested considerable time, effort and expense in pursuit of the agreed objective and, as a result, the value of the land was enhanced. However, prior to planning permission being obtained a third party made an offer to the landowner to purchase the land. The landowner wished to sell. The developer, wishing to earn its fee, sought injunctive relief to prevent a sale.

Among 36 numbered express terms set out in a schedule to their agreement, the parties included, at paragraph 33, a clause as follows:

> *"In 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."*

6 At page 138
7 [2007] 3 EGLR 101

It was submitted on behalf of the landowner that one cannot have an obligation of good faith in the abstract; rather the obligation must relate to some other defined matter. Since the agreement contained no express obligation restricting sale of the land, it was argued that such an obligation could not be created out of a good faith obligation. Morgan J rejected that submission and held that paragraph 33 created a general contractual obligation to act with *"the utmost good faith"*.[8]

He then turned to consider the meaning of "good faith". He referred first to *Interfoto*, where Bingham LJ characterised good faith as follows:[9]

> *"[It] does not simply mean that [the parties] 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 and open dealing."*

Morgan J then referred to a wide-ranging discussion of the concept of good faith contained in the judgment of French J of the Federal Court of Australia in the case of *Bropho v Human Rights & Equal Opportunities Commission*.[10] *Bropho* was not a case concerned with the interpretation of a contractual provision but rather the interpretation of the Australian Racial Discrimination Act 1975. But Morgan J, citing two particular passages from French J, said:[11]

> *"… At paragraph 90 he [French J] quoted from dictionaries and Mr Wood [representing the developer before Morgan J] relied in particular on the quotation from Black's Law Dictionary, 7th Edition, West Group (1999) (at 701) and the reference to [the definition of "good faith"]:*
>
> *"Observance of reasonable commercial standards of fair dealing in a given trade or business".*
>
> *At paragraph 92, French J. quoted from the United States Second Restatement of Contracts paragraph 205 which was in these terms:*
>
> *"The phrase "good faith" is used in a variety of contexts and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasises faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterised as involving "bad faith" because they violate community standards of decency, fairness or reasonableness."*
>
> *At paragraph 93 French J expressed the matter thus:*
>
> *"In a statutory setting a requirement to act in good faith, absent any contrary intention express or implied, will require honest action and fidelity to whatever norm, or rule or obligation the statute prescribes as attracting the requirement of good faith observance. That fidelity may extend beyond compliance with the black letter of the law absent the good faith requirement. In ordinary parlance it may*

8 At paragraph [90]
9 See footnote 2 above.
10 [2004] FCAFC 16
11 *Berkeley Community Villages v Pullen* at paragraphs [95]-[96]

> *require adherence to the "spirit" of the law. This may attract the kind of penumbral judgments by courts of which Professor Stone wrote. That is not necessarily a matter for concern in the case of civil proscriptions. They are evaluative judgments which the courts are authorised and required by the legislature to take. A good faith provision offers a warning that game playing at the margins of a statutory proscription or obligation may attract a finding of liability. There is nothing in principle to prevent the legislature protecting a rule by attaching an uncertain risk of liability to conduct in the shadow of the rule."*"

Morgan J saw these authorities as a useful attempt to describe the concept of "good faith". On this basis he interpreted paragraph 33 of the agreement before him:[12]

> *"… as imposing on the Defendants a contractual obligation to observe reasonable commercial standards of fair dealing[13] in accordance with their actions which related to the Agreement and also requiring faithfulness to the agreed common purpose and consistency with the justified expectations of the First Claimant."*

He went on to hold that a sale by the landowner prior to planning permission being obtained would be a breach of paragraph 33 of the agreement. He observed that in the event of a sale the developer would have no contractual entitlement to its fee, despite its efforts having increased the value of the land. He concluded that such a sale did not observe reasonable commercial standards of fair dealing. It did not observe faithfulness to the agreed common purpose and it was inconsistent with the justified expectation of the developer to take the promotion of the land to a conclusion and obtain a fee based on the express terms of the agreement.[14] The developer was granted an injunction to restrain the sale of the land by the landowner.

CPC Group Limited v Qatari Diar Real Estate Investment Company[15]

The Qatari Diar case arose out of the withdrawal of an application for planning permission in relation to the Chelsea Barracks site in London, following an expression of dislike for the architect's design by, among others, HRH the Prince of Wales. By a sale and purchase agreement, CPC Group Limited (CPC) had sold to Qatari Diar its 20% interest in the joint venture, which owned the site in return for an initial consideration of £37.9 million and a deferred consideration of up to £81 million depending upon the future progress made in obtaining planning permission for the site. CPC claimed that the subsequent withdrawal of the application for planning permission was a breach of, among others, an express term, in a section headed *"Protection of Deferred Consideration"*, that the parties would *"both act in the utmost good faith towards each other in relation to the matters set out in this Deed …"*.

Following the approach of Morgan J in *Berkeley v Pullen*, Vos J referred to another Australian case, *Overlook v Foxtel*.[16] That case concerned an implied contractual obligation of good faith contained in a contract for the supply of a subscription television channel. Vos J[17] cited in particular the following passages from the judgment of Barratt J:

> *"65. … It must be accepted that the party subject to the obligation [of good faith]*

12 At paragraph [97]
13 As to the meaning of which see further in this article below.
14 At paragraph [110]
15 [2010] EWHC 1535 (Ch)
16 [2002] NSWSC 17
17 at paragaph [240]

> *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), in words used by McHugh and Gummow JJ in Byrne v Australian Airlines Ltd [1995] HCA 24; (1995) 185 CLR 410, "nugatory, worthless or, perhaps, seriously undermined ".*
>
> *…*
>
> *67. Viewed in this way, the 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: Burger King[18] at para 187. 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."*

Vos J went on to conclude that *"the content of the obligation of utmost good faith in the [agreement] 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."*[19] In the event, on the facts he found that no breach of the duty of good faith had occurred because withdrawal of the planning application was *"not motivated by ill-will or bad faith"* and was one of a number of reasonable responses to the *"extremely difficult"* situation in which Qatari Diar had found itself as a result of opposition to the design.[20]

***Gold Group Properties Limited v BDW Trading Limited*[21]**

The third recent case in this group is *Gold Group v BDW Trading*. It was being heard at the same time as the *Qatari Diar* case, with judgment handed down only days later. The defendant developer agreed to develop a site owned by the claimant by building about 100 private-sale dwellings and 16 units of affordable housing. Minimum sale prices for the dwellings were defined by reference to the prices set out in a Minimum Price Schedule which was itself defined as *"the schedule of minimum prices as set out in the Fourth Schedule or any schedules substituted therefore from time to time by agreement of the parties"*. In addition the agreement included a set of revenue-sharing arrangements under which the net revenues from the development would be divided between the parties in differing percentages according to the aggregate net revenues.

The agreement contained two express terms that required each of the parties to *"at all times act in good faith"* towards one another. When the property market fell the development became uneconomic from the viewpoint of the developer, and so the developer failed to build out the development. Because of the structure of the revenue-sharing arrangements, the landowner's profit would not be affected by the fall in the market and the landowner insisted that the developer must fulfil its development obligations. The landowner sued the developer for repudiatory breach of contract. The developer responded by saying that it could only build the development if the revenue-sharing arrangements and the minimum prices were renegotiated and claimed that the landowner was in breach of its duty of good faith by refusing to countenance any such renegotiation.

18 *Burger King v Hungry Jack's Pty* [2001] NSWCA 187
19 At paragraph [246]
20 At paragraph [277]
21 [2010] EWHC 1632 (TCC)

Mr Stephen Furst QC, sitting as a Deputy High Court Judge, analysed the requirements imposed by the good faith terms. He referred both to *Berkeley v Pullen* and to *Overlook v Foxtel* and concluded: [22]

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

Applying this approach to the facts as he found them, the Deputy Judge held that the landowner was not in breach of the good faith clause by reason of its failure to negotiate a revision of the revenue-sharing arrangements.[23] However, because the definition of *"Minimum Price Schedule"* contemplated future substitution of new minimum prices, he held that a refusal to revise those prices in circumstances which were necessary for the agreement to be performed might have been a breach, though on the facts he found the landowner had not refused to revise the minimum prices. [24]

Compass Group UK and Ireland Limited (t/a "Medirest") v Mid Essex Hospital Services NHS Trust[25]

The fourth case, *Compass Group v Mid Essex NHS Trust*, is the only one of the four cases being considered which did not arise in the context of development of land. Compass (trading under the name "Medirest") provided catering services to the Mid Essex NHS Trust (the Trust) under a long-term facilities contract. The contract imposed on Medirest a series of minimum performance standards and specifications, and entitled the Trust to make deductions from the sums payable to Medirest in the event that those performance targets were adjudged by the Trust's representative not to have been met. A series of deductions made by the Trust had the effect (in the Judge's words) of *"poisoning the relationship between the parties"* to the point that within 18 months of entering the contract both sides purported to terminate it.

The contract contained a clause 3.5 requiring the parties to *"co-operate with each other in good faith and [to] 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"*. In identifying the content of clause 3.5 Cranston J referred to both *Berkeley v Pullen* and *Qatari Diar.*[26] Having done so he went on to conclude:[27]

> *"In the contract in the present case the term good faith in clause 3.5 referred to how the parties were to conduct themselves in the course of its performance. Conduct which could be said to be committed in bad faith was clearly caught. Additionally, in its context, the term had an objective character. It qualified how the duty to co-operate was to occur, that duty having the features already described. Moreover, it concerned the performance of a long term, complex contract, involving the provision of an important service to members of the public, the patients and visitors to the hospital. In deriving the full benefit of the contract under clause 3.5 for itself and the beneficiaries identified in the contract, the Trust was in a real sense pursuing a common purpose with Medirest of benefit to the public. To my mind the objective standard of conduct demanded in this case of both parties primarily encompassed faithfulness to this common purpose. Fair dealing and acting consistently with justified expectations were, in a sense, corollaries of that."*

22 At paragraph [91]
23 At paragraph [98]
24 At paragraphs [100] – [101]
25 [2012] EWHC 781 (QB), [2012] 2 All ER (Comm) 300, appeal pending
26 At paragraphs [31] and [32]
27 At paragraph [35]

The Judge found that the Trust was in breach of the good faith clause. Specifically he found that many of the calculations applied by the Trust in making deductions from the sums payable to Medirest were *"absurd"* and made the Trust's exercise of its power to make deductions *"arbitrary, capricious and irrational"*.[28] He also held that the Trust *"acted in a manner calculated, at least objectively, to impose the largest possible service failure points irrespective of the lack of justification"*.[29]

Validity of a general contractual obligation of "good faith"

The first and most obvious conclusion to be drawn from these cases is that an express good faith term will impose a separate and self-standing obligation on the parties to behave in the manner required, and will be upheld and enforced by the Court. This is important because uncertainty over the scope and extent of a general duty of good faith is one of the reasons traditionally cited against adoption of such a principle in English contract law. Hitherto, *Walford v Miles*[30] had left a lingering doubt as to whether a general good faith term was sufficiently certain to be enforceable. Be that as it may, where the parties have agreed to include an express clause requiring good faith, it is now clear that the Court will uphold it.

As we have seen, in *Berkeley v Pullen* Morgan J specifically rejected the submission that an obligation of good faith could not exist in the abstract but must relate to some other defined matter.[31] None of the subsequent cases has cast doubt upon that conclusion. On the contrary each of them proceeds on the basis that such a clause is both valid and enforceable, and is capable of creating fresh obligations. It is now clear that *"having a contractual obligation of good faith in the performance of the contract presents no conceptual difficulty in itself."*[32]

Such an express good faith clause will thus do more than simply regulate the performance of other express terms of the contract. It is capable of obliging a party not to do things which it would otherwise be permitted to do under the terms of the contract. In *Berkeley v Pullen* this resulted in the landowner being prevented from selling its land, despite there being no term in the contract directly prohibiting such a sale. In *Qatari Diar*, had the facts been different, there is every reason to believe that the Judge would have been willing to hold that the good faith term was capable of preventing withdrawal of the planning permission. For example, if he had concluded the planning permission was withdrawn with the intention of avoiding or delaying payment of the deferred consideration, or was an irrational response to the circumstances.

Equally, there seems to be no reason in principle why, in an appropriate case, a good faith term ought not to be capable of imposing a self-standing positive obligation upon a party. In *Gold Group v BDW Trading,* the Judge remarked that if he had found on the facts that Gold Group had refused to countenance renegotiation of the minimum prices, that refusal might well have been in breach of the good faith term.[33] Thus the good faith term in that case appears to have been considered capable of requiring the landowner to enter negotiations to revise the minimum prices and to do so with an open mind.

28 At paragraphs [83] to [87]
29 At paragraph [103]
30 Cited above
31 [2007] 3 EGLR 101 at paragraph [89]
32 Per Lord Hobhouse in *Manifest Shipping v Uni-polaris Insurance* [2003] 1 AC 469 at [50]
33 [2010] EWHC 1632 (TCC) at paragraph [100]. The Judge also made reference to an obligation to reach agreement on the schedule of minimum prices, but the express term to which he was referring was the definition of "*Minimum Sale Price*" referred to earlier which simply included reference to prices "*substituted therefore from time to time by agreement of the parties*". The Judge's obiter dicta thus appear to rely to a considerable extent upon the effect of the good faith term.

Meaning of "good faith"

It can be seen from the cases that the concept of good faith has more than one possible meaning. In any given express clause, the term will of course take its meaning from the precise contractual context in which it is used.

The formulation of Morgan J in *Berkeley v Pullen* was cited with apparent approval in each of the other three cases. For the time being at least, it is the starting point for any analysis of the meaning and effect of a good faith term. Thus a good faith term is:[34]

> *"… a contractual obligation to observe reasonable commercial standards of fair dealing in accordance with their actions which related to the [a]greement and also requiring faithfulness to the agreed common purpose and consistency with the justified expectations of the [parties]."*

That formulation suggests good faith can encompass several related meanings.

The first meaning of good faith is *"to observe reasonable commercial standards of fair dealing"*. This is the aspect of good faith that is most familiar to English law. As Bingham LJ said in *Interfoto*, good faith is *"in essence a principle of fair and open dealing."*[35] This in itself encompasses different elements:

1) Good faith will usually require full and frank disclosure of facts that are material to the performance of the contract.[36] This is analogous to the principle of law that requires the assured entering into a contract of insurance to disclose to the insurer all those material facts of which a prudent insurer would take account when assessing the risk.[37] Understood in this sense, a duty of good faith is capable of overriding the general absence of any duty to speak, or obligation to bring difficulties and defects to the attention of a contractual counter-party.[38] A requirement to act in good faith towards the other party will restrict, or even remove, the ability of one party to withhold information from the other party relevant to the performance of their contract.

2) A good faith clause can also place a limitation upon the way in which one party is permitted to exercise a contractual power so as to prohibit not just malicious exercise, but also the arbitrary, capricious or irrational exercise of the power. There is a close analogy here with line of cases in which the Courts have implied restrictions upon a broad contractual power so as to prohibit it being exercised dishonestly, capriciously or arbitrarily.[39] Although each case ultimately turns on its facts, this line of cases reflects a marked reluctance on the part of the Court to go further and imply a term requiring that such a power be exercised "reasonably". The decision of Cranston J in *Compass Group* suggests that a Court interpreting the effect of a good faith term will adopt a similar approach. Cranston J held that ill-intentioned or absurd calculations of financial deductions in that case were a breach of the good faith term. Cranston J appears to have used the term "absurd" here to mean calculations which had no objective basis in reality, and were "indefensible". This probably means something more than merely unreasonable.

34 [2007] 3 EGLR 101 at paragraph [97]
35 [1989] QB 433
36 By contrast the good faith term cannot normally require full disclosure of facts material to the negotiation of the contract because it cannot take effect until the contract has been concluded.
37 *Bank Keyser Ullman SA v Skandia* [1990] 1 QB 665
38 See Rix LJ in *ING v Ros Roca* [2011] EWCA Civ 353 at [92] for a recent summation of the general rule
39 See e.g. *Paragon Finance Plc v Nash* [2002] 1 WLR 685; *Lymington Marina v MacNamara* [2007] EWCA Civ 151

3) A third element to fair dealing is a willingness to engage with the other party to the contract in resolving any difficulties that arise during the performance of the contract. This is illustrated both by *Gold Group* and by *Compass*. In *Gold Group* the Judge interpreted the good faith term as requiring the landowner to contemplate and at least be willing to engage in negotiations to reduce the minimum prices in circumstances in which it was necessary to permit the contract to be "*performed as envisaged*".[40] In *Compass* Cranston J identified a separate breach in the failure of the Trust, having put forward absurd calculations, thereafter to *"respond positively when Medirest protested the calculations and sought to resolve the dispute"*.[41]

Returning to the other parts of Morgan J's formulation of the meaning of "good faith", the second and third meanings identified by him introduce more novel concepts. These comprise *"requiring faithfulness to the agreed common purpose"*, and *"consistency with the justified expectations"* of the other party. It is unclear to what extent they differ. Until the four recent cases referred to above there was little authority on these aspects in English law.

Applying these aspects of a good faith clause requires the Court to identify *"the agreed common purpose"* and / or *"the justified expectations"* of the parties to the contract. This might also be described as identifying *"the spirit of the contract"*.[42] This involves standing back from the black letter of the contractual terms and identifying the overall objective of the contractual adventure, whether it be expressed or unexpressed. An analogy might be drawn here with the identification of the 'end' or 'aim' of a contract for the purposes of applying the principle against derogation from grant. In *Myers v Catterson* Bowen LJ described this as the search for *"the reason of the thing"*:[43]

> *"As in the case of all other implied covenants, or implied obligations, in order to see what the measure of the obligation is we must look at the reason of the thing, and at the surrounding circumstances, in order to ascertain, if we can, what was the obvious intention of the parties, so as to give to the transaction between them that minimum of efficacy and value, which, upon any view of the case, it must have been their common intention that it should have."*

Having identified the common purpose and justified expectations of the parties, then the Court must seek to balance the entitlement of one party to pursue its own commercial objectives in accordance with the express terms, against the expectations of the other party that the "spirit" as well as the letter of the contract will be observed. *Ex hypothesi*, at this point in the analysis the Court will usually be addressing an aspect of the parties' relationship which is not dealt with expressly elsewhere in the contract. The task will be to identify the unspoken assumptions and expectations underlying the contract and seek to balance their protection against the application of the other express terms. This will give rise to difficult questions of interpretation. From the cases it is possible to offer some tentative guidance on the approach the Courts might take.

Gold Group v BDW suggests that it will be a very rare case in which the balancing exercise required in applying a good faith term will be struck so as to require one party to give up its unqualified express rights under the contract. In that case the Judge concluded that the good faith term could require a willingness on the part of the landowner to revise the minimum sales prices, in relation to which the possibility of revision was clearly contemplated within the agreement, by the wording

40 [2010] EWHC 1632 (TCC) at paragraph [100].
41 [2012] EWHC 781 (QB) at paragraph [83]
42 Per Vos J in *Qatari Diar* at paragraph [246] applying *Overlook v Foxtel* [2002] NSWSC 17
43 (1890) 43 ChD 470 at 481

of the "*Minimum Price Schedule*" definition.[44] By contrast the Judge rejected the suggestion that the landowner could also be forced to renegotiate the revenue-sharing arrangements. In relation to those arrangements there was nothing in the contract to indicate that at the time the contract was concluded, the parties had contemplated them being revised in future. As a result the Judge concluded they were a *"freely negotiated financial advantage clearly embedded in the contract"*[45] and adherence to the good faith term did not require the landowner to revisit them.

On the other hand, *Berkeley v Pullen* suggests that a good faith term will often enable the Court to fill a gap left in the express terms of the contract, the exploitation of which would infringe the "spirit of the contract", if not its letter. The landowner in that case sought to argue that the developer could be suitably recompensed in the event of an early sale of the land to a third party by payment of a reasonable fee to the developer for the services provided up to that date in promoting the land. Morgan J concluded that payment of such a fee would not be consistent with the justified expectations of the developer. He said:[46]

> *"… the [developer]'s expectations under the Agreement were not to receive what a court might consider to be a reasonable fee at this point in the project of promoting the land but the [developer]'s expectations were to take the promotion of the land to a conclusion involving (if possible) the obtaining of a [c]onsent and a sale on the open market whereupon the [developer] would be entitled to a fee based on the express contractual terms as to calculation of the fee."*

In other words premature sale of the land coupled with a quantum meruit, whilst not prohibited by the other express terms, would have amounted (in the rather evocative phrase of Barratt J in *Overlook v Foxtel*)[47] to a *"cynical resort to the black letter"* of the contract and was thus a breach of the good faith term. In *Berkeley v Pullen* the "black letter" of the contract was forced to yield to the justified expectation of the developer to have a chance to earn a fee calculated in accordance with the terms agreed.

By contrast, in *Qatari Diar*, Vos J concluded that the defendant's actions had not gone beyond the legitimate pursuit of its commercial interests. CPC alleged that the withdrawal of plans for the Chelsea Barracks site and promotion of a fresh outline planning proposal constituted a breach of Qatari Diar's obligation of utmost good faith in that it was done wholly to promote the interests of Qatari Diar and resulted in delay and reduction of the deferred consideration. Vos J rejected this claim. He identified the spirit of the contract as being *"to seek to obtain planning consent for the maximum developable area in the shortest possible time"*. In balancing the parties' interests in seeking to reach this objective he concluded that the parties' commercial interests were not intended to be entirely subjugated to the pursuit of the planning application to the exclusion of all else, and so there was no breach of contract by Qatari Diar in seeking, for example, to withdraw the existing planning application having regard among other things to *"political"* considerations and a desire not to *"make enemies in high places"*. Its actions were a legitimate response to a difficult situation.

General and specific "good faith" clauses

It can be seen from this that a good faith term is capable of having a significant effect upon the scope and extent of a party's rights under a development agreement. Moreover the effects of the good faith term may be hard to predict at the time the contract is originally entered in to. It is important

44 Cited above
45 [2010] EWHC 1632 (TCC) at paragraphs [91] and [98]
46 [2007] 3 EGLR 101 at paragraph [109]
47 [2002] NSWSC 17 at paragraph [67]

therefore to establish whether the good faith term in question is of general application or applies only to specific parts of the contract, and if so which.

The parties to an agreement are, of course, free to agree in whatever terms they see fit a clause requiring one or both of them to act towards the other in "good faith". It is far from uncommon to find in a development agreement a general duty of good faith in very wide terms. In *Berkeley v Pullen* the good faith term included by the parties in their agreement was as follows:

> *"In 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."*

A clause such as this has the potential to affect the performance of each and every aspect of the development agreement.

In other cases the parties will agree to act in good faith in relation to a specific aspect or aspects of their relationship, such as in the determination of the price payable for development land or the obtaining of planning permission.

It is a matter of construction as to whether a particular good faith clause gives rise to a general duty or a specific duty of good faith. It may not be easy to determine. In *Compass Group* the contract between Medirest and the Trust contained a clause in the following terms:

> *"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."*

Medirest contended that the first part of this clause imposed a general obligation to co-operate in good faith, whilst the Trust contended for a narrower construction whereby the good faith obligation was confined to the specific purposes set out thereafter. In the event Cranston J concluded it was unnecessary to resolve this dispute because the actions of the Trust were a breach of the good faith duty even on its own narrower construction. But he said:[48]

> *"If it had been necessary to choose between these rival interpretations I would have favoured that advanced by Medirest, i.e. that there was a general obligation to co-operate in good faith. In Rainy Sky v Kookmin Bank[49] … the Supreme Court reiterated that if a clause in a commercial contract is open to different interpretations, the court should generally adopt the interpretation which more closely accords with commercial common sense: [30]. That is the interpretation which the reasonable person, who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to mean: [14], [21]. Here Medirest and the Trust had entered a long term contract for the delivery of food and other services within a hospital, the performance of which required continuous and detailed co-operation between the parties at a number of levels if it was to work smoothly. In those circumstances, it is highly likely that the parties intended that there should be a general obligation that they should cooperate in good faith with each other. The only limitation to that general*

48 [2012] EWHC 781 (QB) at paragraph [25]
49 [2011] UKSC 50; [2011] 1 WLR 2900

obligation would be that it would be limited to the performance of the contract."

Although *Compass Group* concerned a different type of long term contract and one perhaps requiring a greater degree of day-to-day co-operation, it is suggested that this sort of reasoning will often be applicable in cases concerning development agreements. Such agreements often share with a facilities contract the characteristics of binding the parties together over a period of months or years during which period they are required to co-operate together either regularly or at least periodically, for example in agreeing development proposals, plans and specifications, and sharing information on revenues and pricing. If so, such circumstances will tend to militate in favour of a wide interpretation of a good faith term.

A good faith term must always be understood in its proper contractual context and its scope and extent may be limited as a result. In *Qatari Diar*, Vos J said that the obligation of good faith *"must take its colour from the commercial context of the contract"*. He had regard to the fact that the good faith term in that case appeared in a section of the contract headed *"Protection of Deferred Consideration"* and concluded that *"it is, therefore directed at things that might be done or not done in connection with the pursuit of the Planning Application, the success of which would trigger that consideration."*[50]

Does breach of a "good faith" term require subjective "bad faith"?

At the heart of the difficulties in applying duties of good faith lies the question of whether such a duty requires only a clear conscience (i.e. subjective good faith) or whether it imports an objective standard of fair dealing independent of personal conscience (i.e. objective good faith).[51]

The recent cases referred to above suggest that the Courts are increasingly willing to interpret good faith terms as requiring more than simply subjective good faith and as imposing an objective standard as well.

Again, it is crucial to interpret the good faith term in question in its particular context. There will be cases in which a good faith term, properly interpreted, seeks only to prohibit what has traditionally been understood as subjective bad faith.[52] Indeed this might be said to be the starting point in analysing the meaning of a good faith term. In the insurance case of *Manifest Shipping v Uni-polaris*, Lord Scott (discussing the post-contractual duty of utmost good faith owed by parties to a contract of insurance) said:[53]

> *"I would, however, limit the duty owed by an insured in relation to a claim to a duty of honesty. ... Unless the assured has acted in bad faith he cannot, in my opinion, be in breach of a duty of good faith, utmost or otherwise."*

Although he found it unnecessary to decide the point, Vos J in *Qatari Diar* cited Lord Scott's words

50 [2010] EWHC 1535 (Ch) at paragraph [243]

51 Furmston Law of Contract (2009) paragraph 1.84

52 I.e. "dishonesty". There is of course an extensive body of case law as to the precise meaning of "dishonesty" in different contexts. See for example *Twinsectra v Yardley* [2002] AC 264 in the context of accessory liability for breach of trust. This is not the place for a detailed discussion of the various approaches.

53 [2003] 1 AC 469 at paragraph [111]. *Rainy Sky v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900 See too his comments, again in a different context, in *Medforth v Blake* [2000] Ch 86 at page 103B: "*I do not think that the concept of good faith should be diluted by treating it as capable of being breached by conduct that is not dishonest or otherwise tainted by bad faith. It is sometimes said that recklessness is equivalent to intent. Shutting one's eyes deliberately to the consequences of what one is doing may make it impossible to deny an intention to bring about those consequences. Thereapart, however, the concepts of negligence on the one hand and fraud or bad faith on the other ought, in my view, to be kept strictly apart.*"

in *Manifest Shipping* and remarked that *"it might be hard to understand ... how, without bad faith, there can be a breach of [a duty of good faith]"*.[54] Vos J found no subjective bad faith on the facts of that case.

However, in the other three recent cases an objective test has been applied. In *Compass Group* Cranston J was not persuaded of the relevance of Lord Scott's words to the good faith term he had to consider. As we saw earlier he concluded that conduct falling short of subjective bad faith could breach the term:[55]

> *"Conduct which could be said to be committed in bad faith was clearly caught. Additionally, in its context, the term had an objective character. It qualified how the duty to cooperate was to occur, that duty having the features already described. ... To my mind the objective standard of conduct demanded in this case of both parties primarily encompassed faithfulness to this common purpose. Fair dealing and acting consistently with justified expectations were, in a sense, corollaries of that."*

Compass Group was of course not a case concerning development of land and the term in that case required the parties to *"cooperate in good faith"*. However, the general approach taken by Morgan J in *Berkeley v Pullen* seems to be predicated upon the imposition of an objective standard of fair dealing. It is clear that, in *Berkeley*, Morgan J applied an objective test. He held that the landowner was in breach of the good faith term in seeking to accept an offer from a third party to purchase the land without making any finding that the landowner was acting dishonestly or with subjective bad faith. Again, in *Gold Group*, Stephen Furst QC, applying the same approach as Morgan J in *Berkeley*, acknowledged that a refusal by the landowner to renegotiate the minimum prices for the sale of the units might have breached the good faith term apparently regardless of whether such a refusal was made with subjective bad faith:[56] such a refusal was capable of falling below the objective standard of conduct required in allowing the other party to enjoy the anticipated benefits of the contract.

This is consistent both with the flexibility of the approach taken to duties of good faith, and with principles of contractual interpretation. Lord Scott's proposition that bad faith means dishonesty or the like is a common sense starting point consistent with the ordinary meaning of the term "good faith" and its antithesis. But the Courts are familiar with an extended concept of good faith which falls to be judged by an objective standard. One need look no further for this than the *"utmost duty of good faith"* in insurance law. Whilst the post-contractual duty analysed in *Manifest Shipping*[57] is one of honesty, the pre-contractual duty of utmost good faith is breached by any failure to disclose material or information which a reasonably prudent insurer would regard as relevant to assessing the risk to be insured. That imposes an objective test which can be breached by mere negligence, regardless of state of mind of the assured.

"Good faith" and "utmost good faith"

It is submitted that in most cases, the inclusion of the word *"utmost"* will have little or no impact on the precise meaning of a "good faith" term. In *Manifest Shipping*, Lord Scott saw little to be gained from debating whether the word "utmost" added anything material to the nature and understanding of the duty of good faith. In that case the House of Lords drew a clear distinction between the application of the duty of *"utmost good faith"* in insurance law pre- and post-contract, recognising an objective standard

54 [2010] EWHC 1535 (Ch) at paragraph [246]
55 [2012] EWHC 1781 (QB) at paragraph [33]
56 [2010] EWHC 1632 (TCC) at paragraph [100]
57 [2003] 1 AC 469

of disclosure was required prior to a contract being entered into, but deciding that post-contract the duty was merely one of subjective honesty. None of the four recent cases we have considered turned on the inclusion or exclusion of the word "utmost" from the clause in question.

In the recent case of *SNCB Holding v UBS*,[58] Cooke J appeared to suggest that the use of the word *"utmost"* is indicative of a wider duty of good faith to be judged by an objective as opposed to a subjective standard. The Court was required to interpret two clauses requiring the parties to act in good faith contained in a deposit agreement between two banks. Cooke J held that in both clauses *"good faith"* meant no more than honesty. Thus in a clause concerning the calculation of the market value of various assets a good faith duty would be breached by a deliberate mistake, but not by an accidental mistake whether negligent or not.[59] In analysing the meaning of *"good faith"* Cooke J said: [60]

> *"There is, in my judgment a clear distinction between "good faith" on the one hand and "utmost good faith" on the other. The latter concept is familiar in the context of insurance, with its concomitant duties of full disclosure, but has been held in other contexts, when used in commercial contracts, to impose "a contractual obligation to observe reasonable commercial standards of fair dealing, faithfulness to the agreed common purpose and consistency with the justified expectations" of the other party. (See e.g. Morgan J in Berkeley Community Villages v Fred Daniel Pullen …). The content of the "utmost good faith" obligation may well vary with the context or contract in which it is found, but in my judgment, it is an expression which has conveyed a meaning beyond "good faith" for a very long period of time. A duty to exercise "good faith" in doing something is one which is usually to be contrasted with a duty to exercise reasonable care. It connotes subjective honesty, genuineness and integrity, not an objective standard of any kind, whether reasonableness, care or objective fair dealing. It cannot be equated with "utmost good faith" and although its exercise in practice may involve different actions or restraint, the concept is not one which goes beyond the notion of truthfulness, honesty and sincerity."*

It remains to be seen whether Cooke J's terminology will catch on as a descriptive approach to categorising different good faith duties. But it should not be taken to mean that the use of the word *"utmost"* will usually be decisive in favour of an interpretation requiring objective good faith. There is nothing in the ordinary meaning of the word *"utmost"* to suggest it should have this effect. There is no support for it either in the four cases we have been considering. In *Qatari Diar*, Vos J *(albeit obiter)* expressed a reluctance to interpret a clause requiring "*utmost good faith*" as imposing an objective standard. Conversely both in *Gold Group v BDW* and in *Compass Group* the Court interpreted clauses requiring mere "*good faith*" as imposing an objective standard. None of those three cases appears to have been cited to Cooke J in *SNCB v UBS*. Thus each contract must be interpreted in its own context and the use of the word "utmost" will at best be only one pointer to the intention of the parties.

Implication of a term of good faith

Notwithstanding the increasing deployment of express good faith clauses in development agreements, it is likely to remain difficult to argue successfully for the implication of a general good faith clause.

As referred to above, the implication of a specific good faith term is not uncommon in certain recognised categories of case. For example the Courts have often implied a restriction upon a broad contractual

58 [2012] EWHC 2044 (Comm)
59 At paragraph [110]
60 At paragraph [72]

power requiring it to be exercised in good faith so as to prohibit it being exercised dishonestly, capriciously or arbitrarily.[61] Again, in the context of a joint venture or circumstances closely akin or analogous to a joint venture, the Court will be more willing to imply an obligation of mutual good faith.[62]

Outside of these specific categories of case, a general duty of good faith will not lightly be implied into a development agreement. It will be very difficult for such a term to satisfy the test of being necessary for business efficacy. In *Ross River v Cambridge City*[63] Briggs J said:

> *"In relationships falling short of partnership, but having in them elements of joint enterprise or joint venture, there is no hard and fast rule as to the existence or otherwise either of a duty of good faith, a fiduciary duty or a duty of disclosure. Each case will turn on its own facts, but if the relationship is regulated by a contract, then the terms of that contract will be of primary importance, and wider duties will not lightly be implied, in particular in commercial contracts negotiated at arms' length between parties with comparable bargaining power …"*

That said, those cases in which the potential for an implied general good faith term has been recognised share certain characteristics with many development agreements. In *Philips Electronique v BSkyB*,[64] the Court of Appeal considered the implication of terms into a long-term contract for the development, manufacture and supply of satellite receivers. Although on the facts it was not relevant, Bingham MR remarked obiter that *"for the avoidance of doubt … we would, were it material, imply a term that BSB should act with good faith in the performance of this contract"*.[65] In *Dymocks Franchise Systems (NSW) Pty Ltd v Todd*,[66] the Privy Council left open the possibility that a general obligation of good faith might be implied into a franchise agreement *"giving rise to long-term mutual obligations"*.

Many development agreements likewise give rise to a long-term relationship requiring a degree of cooperation between the parties comparable to that under a franchise or supply agreement. In such cases there may be increased scope on the facts of an individual case to argue for the implication of a good faith term. It will be easier to contend that performing in "good faith" must have been intended by the parties or is necessary to make the agreement workable. But it will still be a rare case in which the implication of a general good faith term would succeed.

Conclusion

In a relatively short space of time, the good faith term has become an important feature of the contractual landscape, commonly agreed between parties to a development agreement. The English Courts have greeted the arrival of the good faith term by moving relatively quickly from scepticism to a clear willingness to apply such a term as an independent obligation with a potentially decisive effect upon the scope and effect of the parties' other obligations. Whether this development will lead developers and landowners to be more circumspect about including such a term remains to be seen. But for the moment at least the good faith term has come of age and looks set to be the subject of increasing attention in litigation over the years to come.

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61 See e.g. *Paragon Finance Plc v Nash* [2002] 1 WLR 685; *Lymington Marina v MacNamara* [2007] EWCA Civ 151

62 See *Ross River Ltd v Cambridge City Football Club Ltd* [2008] 1 All ER 1004, and *Ross River v Waveley Commercial* [2012] EWHC 81 (Ch)

63 ibid at paragraph [197]

64 [1995] EMLR 472

65 Ibid at page 484

66 [2002] 2 All ER (Comm) 849, though this was a case in which the Privy Council was applying the law of New South Wales. Contrast *Jani-King (GB) Ltd v Pula Enterprises Ltd* [2008] 1 All ER (Comm) 451 where the Court refused to imply a duty of trust and confidence into a franchise agreement.