

## What are good faith duties in a land purchase contract, and can they be implied?

In development agreements (whether options, promotion agreements, collaborations and so on) 'good faith' clauses can often be found buried towards the back of the document, usually amongst the other 'boilerplate' provisions.

These seemingly innocuous clauses are increasingly used, and may be accepted freely enough when doing the deal, but careful thought needs to be given to what they actually mean and might require of a party several months down the line, particularly if the deal is not going to plan.

Here are a couple of examples: 'The Landowner and the Developer agree to cooperate with each other and to act in good faith towards each other in connection with this agreement and the development of the Property.'

You will note that this is quite wide ranging, and applied in connection with the **whole** agreement, as well as the subsequent development. Such a clause should be thought about carefully and not, from a developer's perspective at least, accepted as a matter of course.

This one is taken from a planning promotion agreement: 'The Owner and the Promoter agree to cooperate fully with each other and to show utmost good faith to each other in the doing of such acts, matters and things as may be consistent with and necessary for the attainment of the objectives of this agreement.'

You will note the use of the word '**utmost**'. The courts do not seem to have imposed a higher standard for that as compared to, say, 'absolute good faith'. The use of the word 'utmost' may be more than just belt and braces, it almost seems to suggest an awareness of potential exposure, and seeks to raise the standard expected accordingly.

When parties use an express good faith clause, it suggests that not every contingency is catered for. So for areas where unforeseen circumstances arise, a duty of

good faith will hopefully see the parties through and perhaps avoid the need to enter into further variation agreements, and, it goes without saying, one party will not seek to take unfair advantage over the other.

Lawyers are usually wary of the liberal use of such clauses. There is a case for including them in relation to certain aspects, such as where land valuations and transparent calculations are needed, or where the parties wish to avoid inadvertent ransom situations arising (e.g. where the precise boundaries of a site are not yet known). But good drafting could arguably seek to cater for those things. If you can anticipate an issue, can you not draft around it, with referral to a third party if you fail to agree at the time? If so, are we therefore just looking at what genuinely cannot be foreseen?

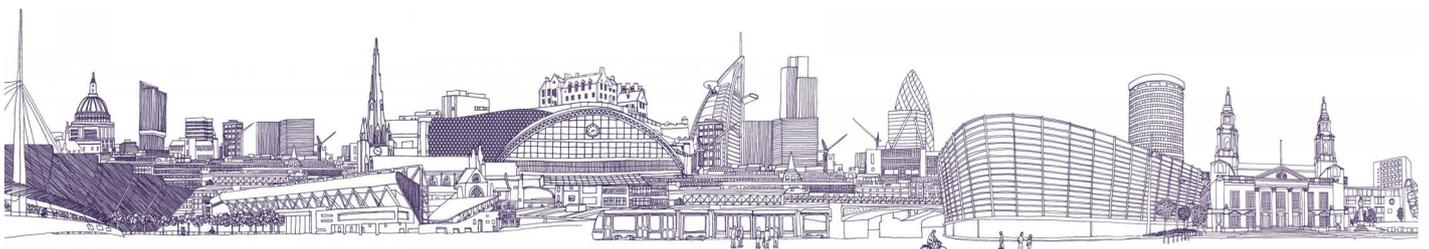
Another area where they are thought to be appropriate is where there may be 'wriggle room' for a party to avoid, or minimise, its contractual obligations, especially if it loses interest in the deal. That is more likely to be a buyer, but could be a seller if it gets a better offer or has lost faith in its buyer.

A common area for disagreement is how quickly a deal is moving, e.g. the developer is not seen to be pursuing its planning application with as much vigour as the seller may have expected: the seller obviously wants to complete quickly, yet the developer may want to run at a slower pace, particularly in a sluggish market, albeit within the parameters of its contract. A seller would probably expect a good faith obligation to become very relevant, and useful, here.

### What might acting in good faith involve?

Another reason many do not favour express good faith clauses is that no one really knows what precise duties they will impose; they could even involve things which neither party anticipated. There is precious little case law to help us here, but what we do know from case law is the duty of good faith may require some of the following:

- i To act in an honest manner.



# Good faith obligations

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- i To 'adhere to the spirit of the contract'.
- i To 'observe reasonable commercial standards of fair dealing'.
- i To be 'faithful to the agreed common purpose'.
- i To 'act consistently with the justified expectations of the other party'.
- i To 'disclose all material facts' (whatever those may be!).

Further, does acting in 'bad faith' automatically mean a breach of good faith? Not necessarily, say the courts, but it is probable that bad faith would lead to a breach.

These principles all sound very reasonable. Clearly context of the deal here is very important and the courts will also take into account whether both parties had appropriate professional advice and it was an arm's length deal.

It should also be noted that the good faith duty is unlikely to be applied to **every** aspect of a contract, but more likely to be limited to specific objectives. The spirit of the contract has to be viewed in light of its common objectives, and so it is useful and advisable to have a clear statement of those objectives in the document.

## Implied duties of good faith

What happens where there is no such clause? Does the law infer a duty of good faith?

It is an established legal principle that there is no **general** doctrine of good faith in English contract law. The parties to a commercial arms-length contract are therefore free to agree what they like, as comprehensively as they wish, and the courts are (quite understandably) reluctant to fill in any gaps or shortcomings.

Despite this, the courts have on occasion commented on implied terms generally, many of which are akin to good faith obligations, so we can perhaps establish the following in relation to implied good faith duties:

- i Once again, an overriding duty of honesty.
- i That a party to a contract should not benefit from his own wrongdoing.

- i The courts apply an external and objective standard, based on how the 'reasonable person' would act.
- i The pursuit of one's own interests is permitted, in other words a contracting party is not obliged to subordinate his own commercial interests to those of his counterpart, so long as this is not done dishonestly.
- i A duty of rationality. This is not the same as acting reasonably. Rationality is more subjective but still applies a minimum standard.
- i The potential application of what is termed 'business efficacy', sometimes known as 'obviousness', i.e. what is required to make the contract essentially work if something has been overlooked.

None of these potentially implied terms would appear to be controversial, and may indeed cater for many of the things for which an express good faith clause might be included, which casts further doubt on the suitability of a good faith provision without careful thought as to what it applies to or what could otherwise be catered for with other specific wording.

**Note: these comments apply in relation to commercial agreements which are subject to the law of England and Wales.**

If you would like to discuss any of the issues raised in this update, please contact:



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