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BELT & ROAD: PART II

"*FAIR PLAY? THE RELEVANCE OF GOOD FAITH IN THE PERFORMANCE OF DEVELOPMENT AND JOINT VENTURE AGREEMENTS*"

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GOOD FAITH IN THE CONTEXT OF THE BELT & ROAD INITIATIVE

At the heart of the Belt & Road Initiative is an eagerness on the part of the People's Republic of China ("PRC") to engage proactively with its neighbours and to build links from east to west thereby promoting international trade. The Belt & Road Initiative is a bold and ambitious project which is still in its relative infancy. Its success will depend on global co-operation and ultimately will be delivered through a network of contracts.

The proposed infrastructure that will form part of, and support, the Belt & Road Initiative will be funded, paid for, and constructed through a broad array of contractual arrangements, entered into between states and state sponsored entities, private and public investors, developers and other relevant stakeholders across the world.

Where parties contract across cultural and legal divides to achieve common objectives, the promotion of good faith in their dealings with each other is likely to be desirable, if not essential. That, in turn, raises questions as to the extent to which different legal systems incorporate requirements of good faith into their laws of contract. These will be relevant considerations for those drafting contracts in the context of the Belt & Road Initiative.

I propose to focus on the key differences between the Chinese law of contract and that in England. China has adopted a uniform civilian code of contract law whereas the English law of contract largely derives from the common law.

GOOD FAITH IN CHINESE CONTRACT LAW

China is a civil law country and the law of contract in China is codified. The Chinese Contract Law ("CCL") was adopted and promulgated at the Second Session of the Ninth National People's Congress in 1999. The CCL is supplemented by two judicial interpretations relating to the CCL issued by the PRC Supreme People's Court ("SPC").

A general duty of good faith is an integral and fundamental part of Chinese contract law. The overarching requirement of good faith is set out in Art. 6 of the CCL which provides that "*the parties shall abide by the principle of good faith in exercising their rights and performing their obligations*". This is one of nine general principles set out in Arts. 1 to 9 of the CCL, which include principles of equal standing (art. 3), voluntariness (art. 4) and fairness (art. 5).

There is no clear promulgation as to what good faith means or requires in any given situation and so the outer limits are unclear. The literal translation of the concept of good faith in the CCL is "*honesty, trustworthiness/ creditability*". The overarching concept of good faith potentially confers considerable discretion on judges, with all the resulting uncertainty that entails.

Academics have addressed the question as to why Chinese law has embraced a seemingly boundless and indeterminable notion of good faith. It has been said that part of the reason is found in Chinese cultural factors, traditionally shaped under the influence of Confucianism and, more recently, reinforced by the socialist value system of the PRC, and that the conferral of a broad discretion upon judges, and the disregard for individual autonomy, is explicable by a long and lasting tradition of the role of a paternalistic government and collectivism.[i]

The overarching principle of good faith in the CCL is qualified by specific provisions, set out later in the code, that deal in more detail with certain specific areas of contract law. In applying the CCL, the general provisions give way to the specific ones. Therefore, the detail of the CCL provides greater certainty as to the principles to be applied in any given situation.

For example:[ii]

> *Article 60 Full Performance; Performance in Good Faith*
>
> The parties shall fully perform their respective obligations in accordance with the contract. The parties shall abide by the principle of good faith, and perform obligations

such as notification, assistance, and confidentiality, etc. in light of the nature and purpose of the contract and in accordance with the relevant usage

Article 125 Contract Interpretation

In case of any dispute between the parties concerning the construction of a contract term, the true meaning thereof shall be determined according to the words and sentences used in the contract, the relevant provisions and the purpose of the contract, and in accordance with the relevant usage and the principle of good faith.

GOOD FAITH IN ENGLISH CONTRACT LAW

In stark contrast to the position in Chinese contract law, the English common law continues to refuse to recognise any general doctrine of "good faith" in contract law.

As Bingham LJ said in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 Q.B. 433 at 439,

> *"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 problems of unfairness*."

The English law approaches this question from an entirely different cultural perspective than the Chinese. The concept of freedom of contract is central and this is based on a tradition of individualism. Parties are free to pursue their own self-interest in negotiating and performing contracts, so long as they stick to the express terms of the contract. The English law of contract values certainty and fears palm tree justice.

That is not to say that good faith plays no role at all, far from it. The English law has developed incrementally, and its preference is for piecemeal development along established lines. This promotes consistency and coherence in the application of the law to any given set of facts.

More exacting standards of behaviour are expected in particular types of contracts, such as insurance, agency and partnership. The common law, supplemented by equity, has developed a number of techniques for countering bad faith. For example, the common law has developed doctrines against both derogation from grant and the imposition of unlawful penalties. There are equitable rules for striking down unconscionable bargains and estoppel can operate to sanction and or mitigate against unconscionable behaviour. Parliament (and wider EU regulation) has intervened, particularly in a consumer context, but also in the regulation of exclusion clauses.

IMPLICATION OF A DUTY TO ACT IN GOOD FAITH?

As a corollary of the failure to recognise a general principle of good faith, and the emphasis on freedom of contract, the courts will not readily recognise a general duty of good faith by the implication of term in the contract to that effect.

The Supreme Court has recently confirmed, in *Marks and Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2016] A.C. 742, that that a term will be implied into a detailed commercial contract only if it is necessary to give the contract business efficacy or so obvious that it goes without saying. This is a high hurdle and it restricts the ability of the courts to fill in gaps left by the contract simply in order to do perceived justice.

In an aligned development, the Supreme Court, in *Arnold v Britton* [2015] A.C. 1619, has re-iterated the importance of construing contracts by reference to the bargain the contracting parties have actually signed up to as expressed by the words that they have used. Even if the contract, as so written, has unforeseen consequences, the court is not entitled to re-write imprudent bargains.

It is interesting to speculate whether the decision in *Arnold v Britton* might have been different if it had been determined according to the CCL. I suspect it might. In that case, Arts. 6 and 125 of the CCL, with their focus on good faith, relevant usage, and the purpose of the contract,

could well have come to the rescue of the long lessees of the chalets there, whose fixed service charges had risen to totally unexpected levels, far in excess of the value of the services they had received from the landlord. They were held to the harsh bargain that followed from a literal reading of the index linking provisions in their leases.

On the other hand, the common law has long guarded against arbitrary and capricious exercise of contractual discretions. In *Braganza v BP Shipping Ltd* [2015] 1 W.L.R. 1661, the Supreme Court has confirmed that the courts will seek to ensure that such a contractual power is not abused, by implying a term, in an appropriate case, that the power should be exercised not only in good faith, but also without being arbitrary, capricious or irrational, in the sense in which that term is used when reviewing the decisions of public authorities.

The courts have, on occasion, implied specific terms into a contract, on conventional grounds, which have had the practical effect of requiring parties to act in "good faith", in the sense of requiring them to adhere to the spirit, if not the letter, of the bargain. A recent example is the case of *Sparks v Biden* [2017] EWHC 1994 (Ch), where a term was implied into an option agreement requiring the buyer/developer of a parcel of land to sell newly constructed dwellings on that land within a reasonable period of time in order to trigger overage payments to the seller. It was there held that the term was necessary as a matter of business efficacy, since without it the agreement lacked practical or commercial coherence.

JOINT VENTURE AGREEMENTS

Implied duties of good faith are recognised, as a matter of law, as applying to certain types of relationship, such as insurance contracts, agency and partnership.

By analogy, the implication of specific duties of good faith may be justified in the context of relational contracts that are analogous, such as joint venture agreements. In *Ross River Ltd v Cambridge City Football Club Ltd* [2008] 1 All E.R. 1004, Briggs J said this,

> *"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 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."*

The English courts might even construe such a contract as giving rise to fiduciary duties on the part of one party to the other. A fiduciary must act honestly and must not allow his own interests to conflict with those of his principal. In one case a profit sharing joint venture agreement for development of premises, under which one party provided finance and the other managed the development, and held the funds and assets, was held to impose a fiduciary duty of good faith, preventing the managing party from disposing of proceeds other than in accordance with the terms of the joint venture agreement.[iii]

However, it has recently been re-iterated[iv] that the court must be careful not to distort the parties' contractual bargain by the inappropriate introduction of equitable principles. In a commercial context, wider duties will not lightly be implied. Fiduciary duties do not commonly arise outside the settled categories of fiduciary relationships, not least because independently contracting parties do not undertake normally to subordinate their own commercial interests to another.

Therefore, the implication of a term of good faith is possible in an appropriate case, but it will be rare, and must be justified by the context and the general law on implication of terms. Such a duty will be more readily implied if the nature of the relationship of the parties requires it.

GOOD FAITH CLAUSES

It has become increasingly common for parties to development agreements to include express good faith clauses within the contract. A number of cases have come before the courts in which the scope and effect of such good faith clauses have been considered.[v]

There is no single meaning attributed to the concepts of "good faith" or "utmost good faith" and the extent of the duty, in any given case, will depend heavily on the context. However, the requirement for good faith has been said to have engaged a number of concepts ranging from the absence of bad faith, to the observance of reasonable commercial standards of fair dealing, faithfulness to the agreed common purpose and consistency with the justified expectations of

the developer. These concepts have much in common with the express factors mentioned in Arts. 60 and 125 of the CCL.

Although the courts have been prepared to recognise and give effect to such clauses, in only one of those cases was a duty of good faith held to have been breached on the facts, namely *Berkeley Community Villages Ltd v Pullen*. The court there went further than simply requiring an absence of bad faith. Instead, the court showed itself willing to use a good faith obligation to address a lacuna in the contract, applying notions of fair dealing according to the spirit or underlying aim of the contract.

Courts are, on the other hand, unwilling to impose general duties of good faith that would contradict express provisions of the contract, deprive a party of freely negotiated advantages bedded in the contract and or require a party to subordinate its own interests to those of the other party.

In *Berkeley Community Villages Ltd v Pullen*, a 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 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. There were no express provisions of the contract preventing such sale. The developer, wishing to earn its fee, sought injunctive relief to prevent a sale.

In that case there was an express term that, "*In all matters relating to the agreement the parties will act with the utmost good faith towards one another and will act reasonably and prudently at all times*."

Morgan J held that the express duty of utmost good faith was engaged. 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. The court adopted an objective, as opposed to merely subjective, standard of good faith that was effective to fill a gap in the contract.

It is interesting to speculate on whether the outcome in that case would have been different had there been no express term requiring good faith. Possibly, although by no means certainly, one

might argue that a term could be implied on a conventional basis, by analogy with *Sparks v Biden*. Further one might speculate whether the outcome in the absence of an express term would be the same if decided according to Chinese law? It is likely that, in light of Arts. 6 and 125, the contract would be interpreted as requiring performance in good faith in the same way.

In other cases, express obligations of good faith have been held not to have been breached on the facts. In both *Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS Trust* and *Sainsbury's Supermarkets Ltd v Bristol Rovers* (1883) Ltd the other terms of the contract were determinative against a finding of "no breach".

In the *Medirest* case, the Court of Appeal, in overturning the decision below, construed the duty of faith restrictively, in the context of an NHS contract out-sourcing hospital cleaning and catering services, as only applying to two particular aspects of the contract (both relating to the effective running of the facilities provided to the hospitals) and not as applying more generally, so as to catch the complained of conduct, which was the awarding of service failure points by the NHS Trust from which it could calculate appropriate payment deductions for the contractors' performance failure. The NHS Trust's conduct in awarding such points, effectively in its own favour, had soured the parties' ongoing relationship and had, at first instance, been held to have contravened requirements of good faith.

In the *Sainsbury's* case it was held that a general good faith clause, within an agreement for the conditional sale and purchase of a football stadium, did not require Sainsbury's to appeal or otherwise apply to vary onerous conditions in a planning consent for the construction of a supermarket on the site, obtained in compliance with reasonable endeavour provisions prior to the expiry of a contractual long stop. The express terms of the agreement only required the claimant to do so in cases where Counsel had determined the prospects to be sufficiently good, which was not the case.

In *Gold Group Properties Ltd v BDW Trading Limited*, a landowner had agreed to sell its land to a developer under an agreement under which it was to share in revenue derived from that development. It was held that the landowner was not in breach of an express good faith clause in refusing to renegotiate the terms of the contract that set out the revenue sharing arrangements between itself and the developer in the event of a fall in the market that made the development

unprofitable from the developer's perspective. The landowner was not required to give up a financial advantage that had freely been negotiated and was embedded in the contract.

In the *Quatari Diar* case, the claimant had sold its interest in a joint venture concerning the Chelsea barracks, to the defendant, for a deferred consideration which was dependent on planning progress. It sought to argue that the defendant was acting in breach of an express obligation to act in the utmost good faith by withdrawing a planning application following public criticism of the design. It was held that there was no breach. The defendant's withdrawal of the original planning application was not motivated by bad faith or ill will and was a reasonable response to the difficulties facing the defendant in light of high profile opposition to the design.

LEARNING LESSONS

Contracting parties from different legal jurisdictions may well have varying expectations and or understandings as to the role good faith has to play in the performance of the contract. It is therefore important that parties and their lawyers appreciate the legal and cultural differences that may exist between them.

The treatment of good faith in contract differs not only between civil and common law systems. Some common law systems have embraced a wider principle of good faith, such as the US and Australia. There are also differences in the treatment of good faith amongst civil systems.

The differences between the English and Chinese approaches may be over-stated, but our different legal systems may well arrive at different answers (or the same answer by different routes) on any given set of facts. Both systems are grappling with inherent tensions between certainty and party autonomy, on the one hand, and fairness and collective good on the other. The relative weight accorded to these competing factors is likely to differ, with the Chinese courts giving more weight to good faith and principles of communality and the English courts favouring certainty and the sanctity of the parties' bargain.

This all has implications for parties drafting and negotiating contracts, both in terms of choice of law clauses and the substantive obligations to be imposed by the express terms of the

contract. Parties intending good faith to have a role to play in the performance of their contracts would be well advised to spell that out carefully in the contract.

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[i] Lei Chen & Larry A. DiMatteo in *Chinese Contract Law, Civil and Common Law Perspectives*, Chapter 1, p.17

[ii] Also see:
*Article 42 Pre-contract Liabilities, "*Where in the course of concluding a contract, a party engaged in any of the following conducts, thereby causing loss to the other party, it shall be liable for damages: (i) negotiating in bad faith under the pretext of concluding a contract; (ii) intentionally concealing a material fact relating to the conclusion of the contract or supplying false information; (iii) any other conduct which violates the principle of good faith".
*Article 62 Article 62 Gap Filling, "*Where a relevant term of the contract was not clearly prescribed, and cannot be determined in accordance with Article 61 hereof, one of the following provisions applies: … (v) If the method of performance was not clearly prescribed, performance shall be rendered in a manner which is conducive to realizing the purpose of the contract".

[iii] *Ross River Ltd v Waveley Commercial Ltd* [2013] EWCA Civ. 910

[iv] *Fujitsu Services Ltd v IBM United Kingdom Limited* [2014] EWHC 752 (TCC), per Carr J at [126]

[v] *Berkeley Community Villages Ltd v Pullen* [2007] 3 E.G.L.R. 101; *CPC Group Ltd v Qatari Diar Real Estate Investment Co* [2010] EWHC 1535 (Ch); *Gold Group Properties Ltd v BDW Trading Limited* [2010] EWHC 1632 (TCC); *Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ. 2000; *Sainsbury's Supermarkets Ltd v Bristol Rovers (1883) Ltd* [2015] EWHC 2002 (Ch); [2016] EWCA Civ. 160.