Coming to terms

Caroline Kehoe deciphersthe meaning of “reasonable endeavours” & “good faith”

IN BRIEF

- The meaning of an endeavours clause, although construed objectively, will depend substantially on the facts.
- An obligation to act in good faith is no more than a requirement to act in accordance with the reasonable commercial expectations of the parties.

Where it is not appropriate to impose an absolute contractual obligation two terms frequently bandied about during negotiations are “reasonable endeavours” and “good faith” but a good deal of uncertainty remains as to what each means in practice.

Endeavours clauses

Before agreeing to any particular terminology it is important to know what the obligation you are committing to really means—what would amount to a breach? The wealth of case law gives some insight but ultimately each case depends on its own facts. In the most recent case, Jet2. Com Limited v Blackpool Airport Limited [2011] EWHC 1529, [2011] All ER (D) 06 (Jul), Mackie J said: “The meaning of the expression remains a question of construction not of extrapolation from other cases…the expression will not always mean the same thing.”

The highest standard

A party that has agreed to use “best endeavours” must “take all those steps in their power which are capable of producing the desired results…being steps which a prudent, determined and reasonable [person] acting in his own interests and desiring to achieve that result would take” (IBM United Kingdom Ltd v Rockware Glass Ltd [1980] FSR 335).

Although it is a higher hurdle, “best endeavours” will still be qualified by a test of reasonableness and would not, for example, require a party to take steps that would lead to the “certain ruin of the company” (Terrell v Mabie Todd & Co [1952] 2 TLR 574) though it could require a party to invest and take the risk of success or failure where there is a reasonable prospect of commercial success. Similarly, it may be superseded by other obligations such as a director’s duty to act in the best interests of the company (Rachman v Peek Food [1990] BCLC 895).

The half way house?

The traditional view as stated obiter in UBH (Mechanical Services) Ltd v Standard Life Assurance Company, The Times, 13 November 1986 is that “all reasonable endeavours” is “probably a middle position somewhere between the two implying something more than reasonable endeavours but less than best endeavours”.

However, Rhodia has been used to argue that it equates to “best endeavours”. The judge stated, obiter: “An obligation to use reasonable endeavours to achieve the aim probably only requires a party to take one reasonable course, not all of them, whereas an obligation to use best endeavours probably requires a party to take all the reasonable courses he can. In that context, it may well be that an obligation to use all reasonable endeavours equates with using best endeavours.”

This was the view taken in Jet2.Com where it was common ground that there was no difference between best and all reasonable endeavours.

It appears more likely that the two standards “all” and “best” endeavours are the same only when considering the number of courses of action a party needs to take and that the other distinctions between these obligations remain.

Considering financial interests

The main area of debate in the cases which have considered the extent of an “all reasonable endeavours” obligation has been the extent to which a party who is subject to such an obligation must, if necessary, subordinate its own financial interests to obtaining the desired result.

In Yewbelle v London Green Developments [2007] EWCA Civ 475, [2007] All ER (D) 379 (May) the Court of Appeal concluded that an obligation to use all reasonable endeavours to reach an agreement with a third party did not require Yewbelle to sacrifice its own commercial interests.

More recently in Jet2.Com the judge drew a distinction between matters that were within a party’s control and those which involved obtaining something from a third party. He concluded that it was improbable that the parties would have used an expression to mean that one of them could
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developed piecemeal solutions in response to no such overriding principle but has law has, characteristically, committed itself QB 433, [1988] 1 All ER 348: “English law does not recognise a general duty of good faith by parties negotiating or performing contracts. As summarised by Bingham LJ in Interfoto v Stiletto [1989] QB 433, [1988] 1 All ER 348: “English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.”

It is, however, reasonably common for parties to include in their contracts either an obligation to act in good faith in their dealings with one another under the agreement or, alternatively, an obligation to negotiate in good faith to reach some further agreement. Both types of contractual term are considered below.

An obligation to act in good faith There is relatively little guidance from the courts on the meaning of “good faith” as a contractual obligation. In Berkeley Community Villages Ltd v F Pullen [2007] EWHC 1330 (Ch), [2007] All ER (D) 36 (Jun), the court considered a clause requiring the parties to “act with the utmost good faith towards one another”. It held that the duty of good faith is essentially to “observe reasonable commercial standards of fair dealing 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 other party]”.

This approach was broadly followed in CPC Group v Qatari Diar Real Estate Investment Company [2010] EWHC 1535 (Ch), [2010] All ER (D) 222 (Jun) where the court found that an obligation of good faith must take its colour from the commercial context of the contract and characterised good faith as an obligation to “adhere to the spirit of the contract...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”.

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In Gold Group Properties Ltd v BDW Trading Ltd [2010] EWHC 1632 (TCC), [2010] All ER (D) 18 (Jul) the parties entered into a development agreement which included an express “good faith” clause. The court held essentially, that an express duty to act in good faith will only go so far and does not require a party to give up its express contractual rights: “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.”

In the very recent case of Horn and others v Commercial Acceptances Ltd [2011] EWHC 1757 (Ch), [2011] All ER (D) 93 (Jul), Peter Smith J considered a clause that “each party shall act in absolute faith towards the other”, concluding (obiter) that the express obligation of good faith imported an obligation to disclose all material facts. Dishonesty was not an essential pre-requisite for a breach of a duty of good faith. Here the defendant had not acted dishonestly, but there was a breach of the clause nonetheless.

Petromec concerned an express agreement to negotiate in good faith contained in a complex agreement, drafted by solicitors, deliberately and expressly entered into whereas in Walford the terms of the purchase of the business were still to be agreed so that the obligation to negotiate in good faith was a “bare agreement to negotiate”. Following Petromec it appears that an obligation to negotiate in good faith may be enforceable where:

- the obligation is part of a contractually binding agreement;
- the obligation is express rather than implied; and
- the matter to be negotiated is capable of objective assessment by a third party.

While Petromec may have gone some way to establishing an exception to the traditional approach to an agreement to negotiate in good faith, each decision will ultimately still be highly dependent upon the particular factual scenario.

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