# The good faith doctrine in English and Canadian Law

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## Introduction

The doctrine of good faith has given rise to a significant and influential judicial doctrine which provides substantial international material for the interpretation and clarification of the doctrine, as well as a large body of academic literature. The Oxford University Obligations Group notes that "good faith is a topic that has been written about at inordinate length, by an almost intolerably wide group of people – some worth reading, some not[2]".

One way of defining the concept of good faith is to deal with it in purely monetary terms. A pre-existing duty of good faith could substitute the duty of building trust between two parties who may be disconnected due to remoteness, but this would require the existence of a dependable description of good faith[3]. The doctrine of good faith could lead to the reduction of costs and encourage economic efficacy. Such a concept could be universally accepted but we are far from a common legal basis for good faith, as illustrated by the different approaches between the courts in the UK and in Canada.

## Good faith under English law and Canadian law: current status

Whilst English law has long been familiar with the concept of (subjective) good faith in the sense of honesty in fact or a clear conscience – which can be found, for instance, in the context of negotiable instruments[4] and the sale of property – until quite recently, the idea of a general doctrine of good faith, in the sense of an overriding (and objective) requirement of fair dealing, was not part of the lexicon of English contract law[5].

There exists a duty of good faith in English Law but only in insurance law, where it was created in the context of the rapid development of maritime trade in the UK. The most recent version of the good faith duty for business insurance is enshrined in the Insurance Act 2015 but it dates from much earlier. For example, in the eighteen century case *Carter v Boehm*[6], which is explored later in this article, Lord Mansfield stated that the governing principle of "good faith" was applicable to "all contracts and dealings".

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[2] "Some Reflections on Good Faith in Contract Law", Oxford University Obligations Group, February 2012, 1.
[3] Paul J. Powers, *"Defining the Indefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods"*, 18 *Journal of Law and Commerce* (1999), p. 350 – 351.
[4] The Bills of Exchange Act 1882 recognized instruments such as bills of exchange and cheques as 'negotiable' which meant, under section 13 of the Negotiable Instruments Act 1881, "a promissory note, bill of exchange or cheque payable either to the bearer.", which required a certain amount of trust for the payer and honesty on the part of the payee.
[5] Roger Brownsword, *"Good Faith", The Law of Contract* (2017), p. 79
[6] (1766) 3 Burr 1905.

The English courts have overlooked what Lord Mansfield said. Rather than applying the duty to 'all contracts', they have focused on insurance to impose a very comprehensive duty of disclosure on the insured. The results of this course of action have in general been seen in contemporary years to be devastating to the insured[7].

English courts have traditionally refused to recognise a duty of good faith in the context of general commercial contract. This looked set to change with the recent case of *Yam Seng Pte Ltd v International Trade Corporation Ltd*[8], in which Leggett J in the High Court ruled that any "hostility" of the English courts towards adopting a general duty of good faith in contracts is misplaced. After reaching the conclusion that there is support in previous English case law for the implication of obligations of good faith in commercial contracts, he found that a general duty of good faith should be implied into a long-term distribution agreement between the parties. Another example is the case of *Bristol Ground School Ltd v Intelligent Data Capture Ltd*[9], where a duty of good faith was implied in a contract under which the parties had cooperated with each other on manufacturing training manuals for commercial airline pilots. Applying the reasoning of Leggett J in *Yam Seng*, the court agreed there was an implied agreement in this case and that a duty of good faith could be implied into ordinary commercial contracts based on the presumed intentions of the parties, albeit ones which involve a longer-term relationship, and a high degree of communication and cooperation.

Hence, it could be advocated that there is a developing principle of good faith of overall application to all commercial contracts under English law but this development is by no way being followed in all common law jurisdictions and some doubts have been casts by English Courts themselves[10]. For instance, in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd*[11], the United Kingdom Court of Appeal did not recognise that the *Yam Seng* case created a general doctrine of good faith.

Generally therefore, aside from insurance contract law, there is no common duty of good faith upon the parties in English law, although certain legal duties between the contracting parties in the law of tort could be seen as similar. If one party is to be held liable to another in negligence, the relationship that must first be established is that of a duty of care, which implies acting honestly. This can be seen in the case of *Esso Petroleum v. Mardon*[12], where the defendant was found liable for providing incorrect information under the tortious remedy of negligent misstatement.[13]

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[7] Modern English case law from the decision of the English Court of Appeal in *Joel v. Law Union and Crown Insurance,* [1908] 2 K.B. 863 (C.A.).
[8] [2013] EWHC 111
[9] [2014] EWHC 2145 (Ch)
[10] In addition to *Mid Essex Hospital v Compass*, see *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2016] EWCA Civ 789
[11] (2013) EWCA Civ 200.
[12] (1976) QB 801.
[13] Esso Petroleum case is based on the principle of misrepresentation and duty of care. In this case Mr, mardon (the plaintiff) had a tenancy agreement of a petrol station with Esso Petroleum (the defendant). The experts hired by the defendant provided budgeted figures of petrol sale expectation based on inflated prices and inaccurate information and so the value of the rent of the agreement was based on these inflated amounts. As a consequence, the plaintiff could not operate profitably. Hence, it was held that the contract could not be voided for misrepresentation as the defendants presented the inflated figure as an estimate rather than as a hard fact. But, they owed a duty of care to the plaintiff to ensure that this was done on the basis of accurate information and so the plaintiff was therefore able to recover the losses which he had suffered as a result of the defendant's negligent misstatement.

In Canada, the good faith principle is now settled law since the Supreme Court of Canada's decision in the important case of *Bhasin v Hrynew*[14], which arose from a dispute concerning non-renewal of a dealership agreement[15]. The Supreme Court findings may be seen as particularly supportive in encouraging an integrated handling of this topic across the common law world. This assertion is supported by the suggestion that the general terms of the Canadian good faith doctrine should be followed so that the unsettled and rather vague common law doctrine elsewhere, including under English law, can be improved. The Canadian Supreme Court case *Bhasin* laid down two chief steps, which are, firstly, to 'acknowledge that good faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance', as well as, secondly, 'to recognise, as a further manifestation of this organizing principle of good faith, that there is a common law duty that applies to all contracts to act honestly in the performance of contractual obligations'. I addition, as is set out below, Canadian insurance law, like English law, has a long history of imposing a duty of good faith in the context of insurance transactions.

**Different historical approaches in the UK and in Canada**

*The English approach*

Under English law, section 17 of the Marine Insurance Act of 1906 codified the duty of good faith for insurance contracts. It required both insured and insurers to act in good faith, failing which the contract could be avoided. However, in practice, the good faith doctrine under the 1906 Act was mostly relied upon by insurers to avoid the contract for non-disclosure of information and misrepresentation[16]. This Act has been the cornerstone of all English marine and non-marine contracts for over a century but it was being seen as unduly harsh on insureds and outdated in light of the rapid developments of commercial practices.

It took many years but the rules concerning good faith in insurance contracts under English insurance law finally changed in 2012. Firstly, the Consumer Insurance (Disclosure and Representations) Act 2012 abolished the duty of utmost good faith for consumer insurance contracts with effect from 6 April 2013. The basic motive of the new law was to safeguard customers by providing more proportionate remedies to insurers in case of there being am innocent or negligent non-disclosure or misrepresentation. Subsequently, the Insurance Act 2015 replaced the duty of utmost good faith with a new duty of fair presentation of the risk for business insurance contract. Although the remedy of avoidance for a breach of the duty of utmost good faith has been abolished under section 14 of the 2015 Act, the duty of good faith under section 17 remains. The English courts have advocated that they will use the good faith principle

[14] (2014) SCC 71.

[15] Harish Bhasin, sold investment products for Can-Am under a dealership agreement that automatically renewed for successive three year terms unless either party gave notice to the contrary at least six months prior to the expiry of any term. There was a history of animosity between individuals at the two entities and a notice of non renewal was used to force a merger wich Bhasin had objected to. This was found to be in breach of an implied duty fo good faith.

[16] Sections 17-20 Marine Insurance Act 1906

as 'a shield rather than a sword', i.e. insurers may be prohibited from exercising an obvious right if they have not dealt with it in good faith. In addition, the 2015 Act was further amended in 2016[17] to introduce a new duty on insurers to pay valid claims within a reasonable time. This recognizes some sort of post contractual duty to act in good faith when handling claims.

Historical reluctance of the English courts regarding the good faith doctrine outside the confines of insurance law is illustrated by the case of *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*[18], where Lord Bingham said English law rather provided "piecemeal solutions in response to demonstrated problems of unfairness". Yet outside insurance law and even before the more recent contractual case law mentioned above, there had been some recognition of a requirement of good faith, for instance under section 61(3) of the Sales of Goods Act, which defines good faith as "honestly, whether it is done negligently or not".

On the one hand it can be said that here are certain problems with the application of the good faith doctrine under English law. As the legal scholar Musy suggests, there have been several instances where parties have demanded remedies for breach of the duty of good faith but the English courts have given their rulings without reference to a specific set of rules concerning good faith, thus leading to ambiguity and inconsistencies[19]. In addition, any party arguing that a term of good faith has to be implied into the contract would need to meet the strict test for implied terms set out in *Marks & Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd*[20].

On the other hand, another legal scholar, Sim, suggests that there has been some progression under English law towards the development a general rule, particularly with the adoption of the Directive on Unfair Terms in Consumer Contracts[21] that contains several references to the concept of good faith. Still, there is only slight judicial progression in this area[22].

Moreover, in the UK, there is also a debate over which standard to agree upon universally. For instance, English courts could apply a standard based on theories such as commercial principles, fair play, objectivity and fairness. In those cases, courts would appear to adopt a tort-like standard external to the agreement of the parties, to rule whether bad faith occurred. Alternatively, courts could rely on a standard that depends on the circumstances and purposes of the contracting parties as made clear in their contract. In this case, courts would try to understand the contract between the parties in order to decide on the correct standard to apply[23].

[17] Under the Enterprise Act 2016
[19] A. Musy, "The Good Faith Principle in Contract Law and the Precontractual Duty to Disclose: Comparative Analysis of New Differences in Legal Cultures", p. 11.
[19] A. Musy, "The Good Faith Principle in Contract Law and the Precontractual Duty to Disclose: Comparative Analysis of New Differences in Legal Cultures", p. 11.
[21] EC Directive on Unfair Terms in Consumer Contracts 1993.
[21] EC Directive on Unfair Terms in Consumer Contracts 1993.
[22] D. Sim, "The Scope and Application of Good Faith in the Vienna Convention on Contracts for the International Sales of Goods".
[23] W. Tetley, "Good Faith in Contract, Particularly in the Contracts of Arbitration and Chartering", p. 27 – 29.

*The Canadian approach*

Canadian law is certainly more advanced in this domain. The development of the good faith doctrine in Canadian law and Canadian insurance law provides an illuminating comparison. The principle of good faith under Canadian common law originates from the English case of *Carter v. Boehm*[24], which recognised the duty of utmost good faith or *uberrimae fidei* in insurance contracts. In that case, Lord Mansfield held that the insured asking or applying for insurance coverage owed a duty of utmost good faith to the insurer to reveal all details substantial to the risk. Thus, this early enunciation of the duty was based upon the inequality of information amongst the proposed insured and the insurer: the insured has an obligation to unveil all appropriate information in order to allow the insurer to correctly evaluate the risk.

The Canadian courts have since imposed the duty of good faith on the insurer as well. There is an implied duty in every insurance contract under Canadian law that the insurer will deal with claims from its insured in good faith[25]. This concept can be seen through the judgment of the case of The Supreme Court of Canada in *Fidler v Sun Life Assurance Company of Canada*[26], following the case of *702535 Ontario Inc. v. Non -Marine Underwriters, Lloyds of London*[27], which stated that "the duty of good faith also requires an insurer to deal with its insured's claim fairly'. The duty to act fairly applies both to the manner in which the insurer investigates and assesses the claim and to the decision whether or not to pay the claim. In making a decision whether to reject a claim from its insured, an insurer must assess the merits of the claim in a balanced and reasonable manner. It must not deny coverage or delay payment in order to take advantage of the insured's economic vulnerability or to gain bargaining leverage in negotiating a settlement. A decision by an insurer to refuse payment should be based on a reasonable interpretation of its obligations under the policy. This duty of fairness, however, does not require that an insurer necessarily be correct in making a decision to dispute its obligation to pay a claim. Mere denial of a claim that ultimately succeeds is not, in itself, an act of bad faith[28].

Furthermore, the constitutional provision of section 18 of the Ontario Marine Insurance Act 1990 imposes a duty of good faith in on both the insured and the insurer and denotes that the duty should be existent for both, before the contractual activities take place and after the contractual phase of the contract begins. For instance, in *Deguise c. Montminy*[29], the Court held that the duty of good faith implied that the insured had to disclose the content of a report suggesting that the existence of pyrrhotite in their rocks could cause damages.

[24] (1766) 3 Burr 1905.
[25](2002) SCC 18 at 650.
[26] (2006) 2 S.C.R. 3.
[27] (2000), 184 DLR (4th) 687 (Ont CA).
[28] 2006 SCC 30 at para 63, citing *702535* at para 29.
[29] See 2014 CanLII 2672 (QC CS).

As set out above, in addition Canadian Supreme Court has now made it clear that good faith is also a requirement that applies to commercial contracts[30]. There is therefore a well-developed jurisprudence and legislation in Canada that requires contractual parties to act in good faith.

**Good Faith: a General Principle or Piecemeal Approach?**

A general good faith doctrine could alleviate injustice but the lack of a predominant and clear doctrine of fair and honest dealing creates legal insecurity. This is the result of a misunderstanding of the supportive nature of the contractual agreement on the unbiased community morals of fairness and trust[31]. The real difficulty for English courts seems to be in finding a principle of general application. In *Walford v Miles*[32], the English court denied any duty to contract in good faith, in spite of the fact that the parties had explicitly agreed to deal in good faith. For Lord Ackner, such a duty of good faith would be 'unworkable in practice[33]'.

Brownsworth's 'pragmatic thesis[34]' suggests that English common law already caters to the good faith doctrine by providing piecemeal solutions for breaches and therefore there is no need for a univeral good faith doctrine[35]. Judges in the UK[36] argue against accepting a requisite of fairness or 'adequacy,' by stating that they only measure the adequacy of contracts. Yet this orthodox position articulated in *Walford v Miles* contravenes the belief that parties have freedom to introduce fair terms into the contract[37].

**Conclusion**

The new legislation recently introduced in the UK to reform insurance law has removed the draconian remedy of avoidance for breaches of the duty of good faith and either abolished the onerous duty for consumers or made it less treacherous for businesses. There has also been some development in the non-insurance realm following the *Yam Seng* decision, even though this remains unsettled.

The above discussion however indicates that there is the scope for several teething problems. Nevertheless, this paper notes that those changes must be welcomed in light of some of the issues that arose with the preceding version of the duty of good faith under English law.

[30] *Bhasin v Hrynew* case described previously.
[31] The Regulation of Fairness and Duty of Good Faith in English Contract Law: A Relational Contract, Theory Assessment, Rosalee S Dorfman, Leeds Journal of Law & Criminology, Vol. 1 No. 1.
[32](1992) 2 AC 128.
[33] *Walford* (n 5) [46] (Lord Ackner); R Halson, *Contract Law* (2nd edn, Longman Law Series 2013) 164– 5.
[34] R Brownsworth, Two concepts of good faith, (1994), 7 JCL 197, 198.
[35] By the use of specific doctrines, such as estoppel, misrepresentation, mistake, frustration, economic duress and others, can be used by Engglish courts to specifically apply these special doctrines rather than general principles as explained in R Brownsword, N Hird and G Howells (eds), *Goodfaith in contract: concept and context* (1999) 13, 21.
[36] *Walford* (n 5) [46] (Lord Ackner); R Halson, *Contract Law* (2nd edn, Longman Law Series 2013) 164– 5.
[37] A Berg 'Promises to Negotiate in Good Faith' (2003) 119 LQR 357, 363.

Canada's stance as to the duty of honest contractual performance should be regarded as an inspiration for English law. It shows that concerns expressed by English courts in relation to good faith are largely misplaced and are not incapable of being settled by legislative guidance and judicial interpretation.