LEAPS OF FAITH:

'GOOD FAITH' OBLIGATIONS BETWEEN SHAREHOLDERS

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Introduction

During lockdown no.2, I attended a virtual seminar panelled by (amongst others) two former lord justices. The theme of the seminar was recent trends in contractual construction, comprising a genial canter through a variety of contract case studies. However, when the chairman of the panel slipped in a question about implied duties of good faith, one of the senior benchers nearly keeled off of his chair. The judiciary, it transpires, are not particularly keen on having swarthy, continental-looking, jurisprudence besmirching the pristine English legal doctrine of contractual certainty. However, where the circumstances absolutely demand it, the lexical corset can be loosened a finger to accommodate the unspoken intentions of the parties. However (like a jaunty weekend away in Amsterdam) it must not be allowed to become a regular thing.

This orthodox view was succinctly put by Lord Ackner in Walford -v- Miles [1992] 2 AC 128:

"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 negotiation".

In short, the parties must protect their own interests, in particular through the negotiation of a clear and concisely worded contract; not by placing vague and subjective burdens upon the other party.

What exactly is a duty of good faith?

A significant difficulty with the concept of a duty to act in good faith is that it is ill-defined, and reliant upon both contractual context and factual circumstance to give it meaning. This difficulty was highlighted by Vos J (as he then was) in CPC Group -V- Qatari Diar [2010] EWHC 1535 (Ch), in which he noted that the doctrine could, for example be deployed to: underwrite the 'spirit' of the contract; encompass a duty to have due regard to the legitimate interests of the other party; and/or require faithfulness to an agreed common purpose and the expectations of the other party. It is this nebulousness that underpins the judiciary's reluctance to welcome the doctrine more readily into the canon of English law.

Relational contracts: Yam Seng Pte Ltd v International Trade Corp Ltd

Notwithstanding the judicial stiffness brought on by debates concerning duties of good faith, there has clearly been a growing acceptance of the concept in recent case-law, and indeed even a willingness to imply a duty to act in good faith in particular circumstances. This trend took root in the case of Yam Seng . In that case, Leggatt J (as he then was) noted that the English jurisdiction was lagging behind civil law jurisdictions and even (surprisingly) other common law jurisdictions in terms of its readiness to imply duties of good faith into commercial agreements. He went on to identify a variety of

contracts in relation to which the Court may be prepared to imply such a duty. A common characteristic of such contracts was that they were 'relational' in nature, i.e. they involved a long-term relationship between the parties, entailing considerable communication, cooperation, and mutual trust and confidence. Keen not to appear too exotic however, the judge couched the decision by reference, in particular, to two steadfast and sober English law concepts:

- **To be implied, the duty to act in good faith must be necessary to give business efficacy to the arrangements; and**
- **The test of good faith is objective, i.e. transgressed by reference to behaviour that reasonable and honest people would regard as commercially unacceptable.**

The judge further added to, and elaborated upon, his thinking in the later case of Astor Management -v- Atalaya Mining [2017] 2 B.C.L.C, in which he confirmed that the duty reflected the expectation that the parties would act honestly toward each other and not deliberately seek to frustrate the purpose of the contract, but the burden of the duty is a lesser one than the requirement to use all reasonable endeavours at achieve a desired contractual outcome.

Good faith between Shareholders

Perhaps no other area of English law encapsulates the tension between contractual certainty and the emerging recognition and application of the duty to act in good faith than relationships between shareholders. On the one-hand, relationships between shareholders (and indeed as between shareholders, directors and the company itself) are governed by statute, the company's constitution and any shareholders' agreement, the latter two of which are (in theory) freely negotiated.

However, as recognised by the Court's extensive equitable jurisdiction under section 994 of the Companies Act 2006, inter-shareholder relationships can be fraught with constitutional and contractual lacunas, such that equity is required to step in to fill the gap. This is particularly evident for 'quasi-partnerships' where the Court will readily look beyond agreed written terms in order to give effect to fundamental understandings that underpin the relationship between the parties, where it would otherwise be unconscionable not to do so (and, exceptionally, even where the act complained of is expressly permitted by the company's constitution). As such, in quasi-partnerships, a duty of good faith will readily be implied, although this arguably adds little to tools of equity already at the Court's disposal in such cases.

More broadly however, shareholder and joint venture agreements are archetypal 'relational' contracts in which the parties could reasonably be expected to act in accordance with the good faith principles outlined above. On this view, you might anticipate that the Court would take a relaxed approach to implying a duty to act in good faith generally. Not so. As stated in Hollington on Shareholders' Rights , the current view remains that:

"…[the minority shareholder] should be aware of their vulnerable and uncertain position and consider the need for and risks of a customised agreement. They should ponder the fate of the grasshopper, in the fable by La Fontaine, who enjoyed the good times and got no sympathy from the diligent and unsentimental ant during the bad times."

Making the leap of good faith

The recent cases of Unwin v Bond and Faulkner & Ors v Collin Holdings Ltd & Ors illustrate the utility (if you are act for a minority shareholder) of including an express duty to act in good faith within a shareholders' agreement. In the former case, the majority shareholder was required to deal fairly and openly with the minority and to have regard to his interests, and it made no difference that the act complained of was in the best interests of the company. In the latter case, even though the Companies Act 2006 allowed the majority shareholders to remove the minority founder directors, they had to exercise that right in line with their good faith obligation, and their failure to do so left them open to a claim for unfair prejudice.

Nevertheless, it is also clear that relying upon an express duty of good faith can still be something of a lottery. The Court's interpretation of what the duty entails on any given set of facts is likely to vary from judge to judge. As such, parties negotiating a shareholders' agreement may be well advised to think deeply and carefully about what it is they actually expect the other party to do and how they expect their relationship to be conducted on a long-term basis, rather than to simply rely upon what seems, on its face, like a reasonable 'catch-all' obligation to play nicely. It's clear the judicial appetite remains deeply rooted in favour of clearly articulated obligations familiar to English law.

So for now, to [mis]quote George Michael: "I guess it would be nice if [good faith obligations] could touch your body [of law], I know not everybody [of law], has a [set of obligations] like you... Because I gotta have [good] faith…"