KEATING CHAMBERS

THE ROLE OF GOOD FAITH AND FAIRNESS IN CONSTRUCTION ADJUDICATION

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19 November 2020

FUNDAMENTAL QUESTION

- To what extent can, or should, requirements of good faith and fairness limit the enforcement of a contract?

MAIN THEMES

Main themes:

- Competing core values in enforcing construction contracts
- What is “good faith” and “fairness”?
- International perspectives
- South African position
- How could or should these concepts influence the adjudication of construction disputes?

COMPETING VALUES IN ENFORCING CONSTRUCTION CONTRACTS

- The first core value – sanctity of contract:
  - Contracts freely and voluntarily concluded must be enforced – "*pacta sunt servanda*"
  - Justified by need for certainty in commercial dealings as much as considerations of morality

COMPETING VALUES IN ENFORCING CONSTRUCTION CONTRACTS

- The second core value – public policy:
  - Courts will not enforce contracts that are contrary to public policy
  - The extent of this limitation is legal system specific
  - Good faith and fairness are recognised in some jurisdictions as values which limit the enforcement of contracts

COMPETING VALUES IN ENFORCING CONSTRUCTION CONTRACTS

- How can good faith or fairness limit the enforcement of a contract?
  - Examples:
    - By vitiating a contract where, during negotiations, a material fact was not disclosed, or by allowing the contract to be enforced on the basis of the innocent party's expectation
    - By invalidating a clause in a contract which is considered unfair or inconsistent with good faith
    - Even where the contract/clause is not invalid, by preventing a party from enforcing a contract term where such enforcement would be unfair or mala fide

COMPETING VALUES IN ENFORCING CONSTRUCTION CONTRACTS

- Competing values:
  - The first and second principles represent competing interests
  - The application of good faith and fairness introduces commercial uncertainty, and it changes the agreed risk distribution of the contract
  - But it fosters a sense of justice and equity in contract – rebalancing the contract

GOOD FAITH: INTERNATIONAL PERSPECTIVES

- The Law of England and Wales:
  - Interfoto Picture Library v Stiletto Visual Programmes Ltd [1987] EWCA Civ 6:

    "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'.

    English law has, characteristically, committed itself to no such overriding principle [as good faith] but has developed piecemeal solutions in response to demonstrated problems of unfairness. "

GOOD FAITH: INTERNATIONAL PERSPECTIVES

- The Law of England and Wales:

  - Yam Seng Pte v International Trade Corporation [2013] EWHC 1111 per Leggatt J:

    "…there seems … to be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying [a duty of good faith] in any ordinary commercial contract based on the presumed intention of the parties."

GOOD FAITH: INTERNATIONAL PERSPECTIVES

- The Law of England and Wales:
  - Court of Appeal in MSC Mediterranean Shipping v Cottonex Anstalt rejects such a general principle:

> *"There is in my view a real danger that if a general principle of good faith were established it would be invoked as often to undermine as to support the terms in which the parties have reached agreement."*

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- The Law of England and Wales:
  - Sir Rupert Jackson:
    - While a general duty has been rejected, a number of decisions from late 2015 onwards have accepted the more limited proposition that, in the particular contractual context of "*relational contracts*" (eg joint venture, franchise or long-term distribution agreements) an obligation that parties act in good faith may be implied in fact.

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Australia:

  - Australian Courts do not accept that an obligation of good faith should be implied generally into commercial or other contracts
  - But have been willing to imply such a duty in contracts where there is a high degree of cooperation and reliance by all the parties on the good faith of each other party, particularly in the context of their working together to achieve a common objective

    - Sir Rupert Jackson

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Singapore:
  - General duty of good faith is not implied in law across the board to commercial contracts
  - But accepts a term to that effect may be implied in fact in the context of contracts which involve a high degree of reliance and partnership

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Canada:
  - Bhasin v Hrynew [2014] SCC 41 (Canadian Supreme Court):

"… there is an organizing principle of good faith that underlines and manifests itself in various more specific doctrines governing contractual performance. That organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily."

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Canada:

"… The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While 'appropriate regard' for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith."

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Canada:

"This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance."

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Conclusion on common law jurisdictions:

  - Common law jurisdictions recognize a duty of good faith, if the contract contains an express term to that effect

  - The common law does not recognize a general obligation of good faith as implicit in all commercial contracts – it is only implied in fact in the case of particular categories of contracts

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Civil law jurisdictions:
  - Good faith is a key concept in all civil law systems
  - Originated in Roman Law – concept of “bona fides”
  - Most civil codes have one or more express good faith provisions

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Civil law jurisdictions:
  - Eg article 242 of the German Civil Code:
    - "an obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration"
  - French Civil Code recognizes good faith as a central principle in the negotiation and performance of contracts
  - Dutch Civil Code recognizes principles of reasonableness and fairness: "redelijkheid en billijkheid"

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Civil law jurisdictions:
  - Quebec Civil Code of 1994:
    - No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner which is contrary to the requirements of good faith.
  - Qatar Civil Code, article 171:

    "A contract shall be performed in accordance with its provisions and in such manner consistent with the requirements of good faith"

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Civil law jurisdictions:

  - Despite recognising good faith and fairness as guiding principles, civil law systems do not necessarily provide judges with a general equitable discretion to decide cases according to subjective notions of fairness

  - There are a number of well-defined rules of application of the principle of good faith which by now lead an independent existence

GOOD FAITH: INTERNATIONAL PERSPECTIVE

- Comparison between common and civil law systems:

  - Common law systems do not recognize a general duty of good faith, civil systems do
  - From a perspective of legal certainty:
    - Common law systems have very limited clear-cut categories of recognition
    - Civil law systems, eg German system, whilst recognising good faith as a fundamental principle, have well-defined categories within which good faith applies – no general get-out-of-jail card

THE MEANING OF GOOD FAITH

- Roman law:
  - *“bona fides”*

THE MEANING OF GOOD FAITH

- Common law:

  - *"playing fair"*
  - *"coming clean"*
  - *"putting one's cards face upwards on the table"*
  - *"performing contractual duties honestly and reasonably and not capriciously or arbitrarily"*
  - *"having appropriate regard to the legitimate contracting interests of the contracting party and not undermining those in bad faith"*
  - *"honest, candid, forthright or reasonable performance"*

THE MEANING OF GOOD FAITH:

- Civil law systems
  - German Civil Code: Treu und Glauben – “fidelity and faith”
  - Dutch Civil Code: reasonableness and fairness

THE MEANING OF GOOD FAITH:

- The difficulty with “good faith” and “fairness” is that these are such broad values that individual judges each have their own view of what these would mean in specific factual scenarios – creates legal uncertainty

THE SOUTH AFRICAN POSITION

- The South African legal system:
  - Founded on Roman-Dutch law
  - Overlaid by English common law
  - Redefined by the Constitution in 1994
  - Constitutional values now underpin the entire SA legal system

GOOD FAITH IN SOUTH AFRICAN LAW

- Origin of good faith principle:
  - Roman concept of good faith:
    - The principle that all contracts are underpinned by the principle of good faith was imported into South African law from Roman contract law via Roman-Dutch law
    - Strict application of law was tempered by *exceptio doli* – offered a defence against party acting in bad faith

GOOD FAITH IN SOUTH AFRICAN LAW

- Pre-1994:
  - Magna Alloys Research (Pty) Ltd v Ellis 1984 (4) SA 874 (A):
    - Whilst public policy generally favours utmost freedom of contract, recognised that our common law does not recognise contracts contrary to public policy
    - But, this power was to be exercised sparingly, and only in the clearest of cases, and did not per se recognise considerations of reasonableness or fairness as grounds for avoiding the contract

GOOD FAITH IN SOUTH AFRICAN LAW

- Pre-1994:

  - As far back as 19th century our courts cautioned that legal certainty would be undermined if good faith was applied as a free-standing principle

  - Innes CJ in Burger v Central SA Railways 1903 TS 571 at 576:

    "Our law does not recognise the right of a court to release a contracting party from the consequences of an agreement duly entered into by him merely because that agreement appears to be unreasonable."

GOOD FAITH IN SOUTH AFRICAN LAW

- Pre-1994:
  - *Exceptio doli* excised from our law in Bank of Lisbon and SA Ltd v De Ornelas 1988 (3) SA 580 (A)
  - Court rejected the notion that courts had an equitable discretion to adjudicate contract disputes with direct reference to fairness and good faith

ENFORCING CONSTRUCTION CONTRACTS

- Pre-1994:

  - But good faith is closely related to the concept of public policy
  - At every stage of the contracting process, from the negotiations through to the performance of the obligations undertaken in the contract, parties are required to behave in a manner consistent with good faith.
    - Meskin NO v Anglo-American Corporation of SA Ltd and Another 1968 (4) SA 793 (W) at 804.

GOOD FAITH IN SOUTH AFRICAN LAW

- Pre-1994:

  - Over a period of a century of court judgments, SA courts developed the common law incrementally to give effect to the principle of good faith:
    - Examples: vitiating contracts procured by misrepresentation, interpreting contracts in a manner consistent with good faith, striking down terms which were contrary to public policy

  - But courts nevertheless generally valued legal certainty above broad values of good faith and fairness

GOOD FAITH IN SOUTH AFRICAN LAW

- Post 1994:
  - Brisley v Drotsky 2002 (4) SA 1 (SCA):
    - Good faith is a fundamental principle that underpins law of contract
    - But does not form an independent basis upon which a court can refuse to enforce a contractual provision
    - Because that would create an unacceptable state of uncertainty
    - But where contracts infringe on fundamental Constitutional values, they will be struck down as being offensive to public policy.

GOOD FAITH IN SOUTH AFRICAN LAW

- Post 1994:
  - Barkhuizen v Napier 2007 (5) SA 323 (CC):
    - Time-bar in insurance contract
    - Public policy as informed by the Constitution imports "*notions of fairness, justice and reasonableness*"
    - Public policy also, in general, requires parties to honour contractual undertakings

GOOD FAITH IN SOUTH AFRICAN LAW

- Post 1994:
  - Enforcement of fairness in contractual context – two stage enquiry:

    "The first is whether the clause itself is unreasonable. Secondly, if the clause is reasonable, whether it should be enforced in the light of the circumstances which prevented compliance with the limitation clause."

  - This greatly expanded the judicial control of unfair terms through invoking a much wider concept of public policy

GOOD FAITH IN SOUTH AFRICAN LAW

- Post 1994:
  - The determination of public policy is now rooted in the Constitution and the objective, normative value system it embodies
  - The Constitution requires that courts employ constitutional values to achieve a balance between freedom of contract and the constitutional values of fairness, reasonableness, justice and ubuntu.

GOOD FAITH IN SOUTH AFRICAN LAW

- Post Barkhuizen:
  - AB v Pridwin Preparatory School 2019 (1) SA 327 (SCA):
    - Public policy demands that contracts freely and consciously entered into must be honoured
    - But a court will declare invalid a contract that is prima facie inimical to a constitutional value or principle, or otherwise contrary to public policy
    - Where a contract is not prima facie contrary to public policy, but its enforcement in particular circumstance is, a court will not enforce it

GOOD FAITH IN SOUTH AFRICAN LAW

- Post Barkhuizen:
  - A court will use the power to invalidate a contract or not to enforce it, sparingly, and only in the clearest of cases in which harm to the public is substantially incontestable and does not depend on the idiosyncratic inferences of a few judicial minds
  - A court will decline to use this power where a party relies directly on abstract values of fairness and reasonableness to escape the consequences of a contract because they are not substantive rules that may be used for this purpose

GOOD FAITH IN SOUTH AFRICAN LAW

- Beadica v Oregon Trust and others (CC) 17 June 2020:
  - Generally confirmed principles in *Pridwin*
  - But indicates that:
    - *Pacta sunt servanda* is not the only or most important principle in the judicial control of contracts – careful balancing exercise between competing constitutional values is required
    - The principle that a court will only intervene on grounds of public policy sparingly and in the clearest of cases should not be overstated

GOOD FAITH IN SOUTH AFRICAN LAW

- The role of good faith and fairness:

  - Public policy encompasses good faith, fairness, reasonableness
  - As such, public policy operates to:
    - Strike down contractual provisions which offend these values; and/or
    - Prevents a party from enforcing an otherwise valid provision when in the circumstances of a particular case, enforcement would offend these values

GOOD FAITH IN SOUTH AFRICAN LAW

- Conclusion on the impact of these constitutional values:

  - Courts will over time through practical application of these constitutional values develop the common law to create more legal certainty by providing practical guidance through case law

  - In doing so, courts are likely to have regard to the manner in which these values operate in other jurisdictions to regulate the enforcement of contracts

GOOD FAITH IN SOUTH AFRICAN LAW

- Examples of how these values could operate:

  - Unreasonably unfair terms where parties have disparate negotiating position
  - Time-bars
  - Disproportionality between value gained by contract enforcer and the cost of performance to performer
  - Unconscionable calls on bonds

THE CONSEQUENCES FOR ADJUDICATION

- The application of these principles to adjudication:
  - Adjudicators equally operate, are subject to, and are bound to apply these constitutional principles in adjudicating construction disputes
  - Adjudicators are obliged, in deciding whether to enforce a particular contract term, to consider whether the term, or a party's enforcement thereof, is consistent with public policy

THE CONSEQUENCES FOR ADJUDICATION

- The application of these principles to adjudication:
  - Such consideration of necessity requires the adjudicator to strike a balance between *pacta sunt servanda*, on the one hand, and considerations of good faith, reasonableness and fairness on the other

THE CONSEQUENCES FOR ADJUDICATION

- The application of these principles to adjudication:
  - This will undoubtedly increase the uncertainty of outcomes
  - But hopefully result in creating a construction industry in which both construction standard form contracts and parties' reliance on the terms of these provisions become more reflective of the values of good faith, reasonableness and fairness

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THANK YOU

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19 NOVEMBER 2020

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