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Contract Administration: A Doctrine of Good Faith

Relational contracting, currently a hot topic in project management, has frequently been touted as the long-awaited solution to the often adversarial working relationship between owners and contractors in the construction industry.

Whichever form of relational contracting comes to your mind, at the core of such co-operative behavior lies the element of trust, (i.e., to rely on others while accepting the risks of disappointment), which may initially occur to someone as a moral or abstract construct. But it also carries a legal implication that can manifest itself in the doctrine of good faith traditionally rooted in the civil law jurisdiction. It is on this note that those readers, who have experiences as project managers and contract administrators, are invited to revisit this matter from a legal perspective.

1. Doctrine of Good Faith

The *Black Law Dictionary* defines the doctrine of good faith as a party who acts honestly and objectively in pursuit of his/her own interests without deliberate intention to defraud the other party under contract.

Take China as an example. One will see that Article 6 of its Contract Law states, “The parties shall observe the principle of good faith in exercising their rights and fulfilling their obligations.”

Ethical as this code may be, the principle behind it goes against the fundamental common law doctrine of “Freedom of Contract,” which recognises one’s legal right to enter into a contract in whatever way he sees fit. In more familiar terms, good faith can be economically interpreted as restricting one’s

liberty when adopting one’s preferred tactics of negotiation and, thereby, creating unnecessary unpredictability and transaction costs in a contractual relationship. For this reason, it is deemed unenforceable.

That being said, there were times when the courts intervened to regulate acts made in bad faith (e.g., misrepresentation and economic duress). The distinction between good faith and bad faith may, however, only be a difference in semantics.

2. Law Cases Related to Good Faith

Let us consider the judicial attitude of Hong Kong courts towards good faith in light of two cases.

2.1 *Hyundai Engineering and Construction Company Limited v Vigor Limited [2005] 3 HKLRD 723*

In the midst of a dispute regarding the enforceability of a supplemental agreement that prohibits each party from pursuing litigation/arbitration and introduces third party mediation as a dispute resolution method, the court’s position is clear when it declares that an agreement to negotiate in good faith is invalid due to a lack of certainty (Paragraph 27).

This is not to say that a promise to negotiate in good faith will never be enforced by a court, as we will see below.

2.2 *Hong Jing Co Ltd v Zhuhai Kwok Yuen Investment Co Ltd [2013] 1 HKLRD 441*

In brief, this is a commercial dispute in which the defendant (“D”), a middleman for the asset owner, was supposed to reach an agreement with the purchaser (“P”), who is the plaintiff in this case, within a time frame, all of which were translated into a memorandum of understanding (MOU) and subsequently signed. Nevertheless, upon the expiry of the exclusivity period, both

parties could not reach a deal and D arranged with another party, with whom it had been negotiating simultaneously, to purchase its assets.

At issue, *inter alia*, is whether D breached an implied term under the MOU, which stated that D was to exercise good faith to reach an agreement with P. It was held that it was necessary to give business efficacy to the contract by implying that D had a contractual duty to act in good faith to seal the deal.

Rather than overrule the previous judgment, this case supplemented it by clarifying when the doctrine of good faith, even if implied, could be enforced. As stated in the court judgment, the MOU did not merely impose an obligation on D to not deal with third parties during the exclusivity period; it also outlined the procedure for acquiring assets. The inference was likely that good faith can apply so long as a readily ascertainable external standard is available for the court to use when it straightens out the ambiguities in the contract.

2.3 Practice in Other Common Law Jurisdictions

Overseas common law jurisdictions have gradually relaxed their oppositions to the doctrine of good faith. For example, the Supreme Court of Canada has, in the case of *Bhasin v Hrynew [2014] SCC 71*, now endorsed it as a formal legal duty and has taken a flexible approach to its application.

As for the English law, the Lord also held, as in the case of *Yam Seng Ptr Ltd v International Trade Corp [2013] EWHC 111*, that a duty of good faith could be implied in a relational contract because it involves a high level of communication and cooperation between the parties. Still, what good faith requires from each party is heavily conditioned by its context.

3. Concluding Remarks

The standard form of building contracts commonly used in Hong Kong does not require parties to act in good faith. Yet, the clause that entitles the contractor to extend the time for events due to the employer's default is precisely an example that forbids each party from acting against good faith (Cheung, 2007). NEC3, on the other hand, expressly mandates each party to act "in a spirit of mutual trust and co-operation" (Clause 10.1).

We will definitely see more relational contracts in the future. At any rate, it will be prudent for us to continue upholding our standards and adhering to such a spirit because how each party behaves in the course of a contract will doubtless influence the outcome of any dispute. Arbitration, to cite an example, can be appointed in the mode of *amiable compositeur* to settle a dispute on the basis of fairness, reason, equity and good conscience, in addition to the contractual requirements.

4. Acknowledgement

Thanks go to a fellow, Mr Deng Hong Chang, who piqued my interests in researching the legal differences that would have a bearing on international project management and led me to write this paper.

My gratitude to the Editorial Board for their assistance.

5. References

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