

# THE DUTY OF 'GOOD FAITH' IN FRANCHISE AGREEMENTS: THE LATEST ENGLISH COURT DECISIONS

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English franchise lawyers have generally been of the view that there is no implied obligation of good faith in a franchise relationship. However, a landmark 2013 High Court judgment held that 'good faith' in the sense of honesty should be implied into commercial agreements which are relationship-based and which require ongoing communication and cooperation between the parties. This principle was first tested in a franchising context in a recent case, which led some commentators to conclude that the principle does not apply to franchising relationships. The author argues however that a standard of good faith is taking shape under English commercial contract law and that it will apply, but only in the right case and on the right facts.

A detailed article published earlier this year<sup>1</sup> considered how the duty of good faith impacts on the on-going relationship between franchisor and franchisee in the civil law jurisdictions of the EU and the common law system in England.

As examined in the previous article, historically English franchise lawyers have generally been of the view that there is no implied obligation of good faith in a franchise relationship. The English courts are reluctant to imply terms into detailed commercial contracts unless the implied term is necessary to

give business efficacy to the agreement or it would 'go without saying' that the parties would assume that such a term was to be implied into their relationship. In addition, English judges have been nervous about the principle of good faith as it is not a clearly defined concept and implying such a duty does potentially impact on the principle that there should be certainty of contractual terms. In the case of *Jani-King (GB) Limited v Pula Enterprises Limited & Others*<sup>2</sup> the franchisee tried, unsuccessfully, to argue that there was an implied obligation of trust and confidence in a franchise agreement and this case therefore supported the general view that there was no implied obligation of good faith.

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<sup>1</sup> Dr Mark Abell and Victoria Hobbs, "The duty of good faith in franchise agreements – a comparative study of the civil and common law approaches in the EU", *International Journal of Franchising Law*, Volume 12, Issue 1, 2014.

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<sup>2</sup> *Jani-King (GB) Limited v Pula Enterprises Limited & Others* [2007] EWHC 2433 (QBD)

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Last year the High Court in London issued a milestone judgment in the case of *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB) and concluded that 'good faith' in the sense of honesty should be implied into commercial agreements which are relationship-based and which require ongoing communication and cooperation between the parties, singling out 'some joint ventures, franchise and distribution agreements' – or more generally what the judge called 'relational agreements' - as examples of agreements where implied good faith was appropriate. The judge held that:

- good faith is recognised in most civil law systems and many US states, it is 'gaining ground' in Canada and Australia, and English law would be 'swimming against the tide' if it resisted it; and
- good faith simply gives effect to the 'presumed intention' of the parties: implying a term of honesty reflects the shared values and norms of the parties.

Understandably, some English law commentators called into question how much impact the decision would have. But the answer is now becoming clear. In the June 2014 High Court case of *Emirates Trading Agency Llc v Prime Mineral Exports Private Limited* [2014] EWHC 2104 (Com) (which concerned a dispute over the failure to deliver product under a long term supply contract), the

judge described the *Yam Seng* judgment as "masterly", and approved the reasoning on the circumstances in which a term of 'good faith' could be implied. In a similar vein, in the July 2014 decision of *Bristol Groundschool Ltd v Intelligent Data Capture Ltd & Ors* [2014] EWHC 2145 (Ch) the High Court ruled that a duty of good faith should be implied into a 'relational' contract for the production and distribution of training materials for pilots. The judge said it is clear from the *Yam Seng* decision that "good faith extends beyond, but at the very least includes, the requirement of honesty" and "[t]he relevant test is that of conduct which would be regarded as "commercially unacceptable" by reasonable and honest people in the particular context involved".

These cases can, however, be contrasted with the July 2014 High Court decision in *Carewatch Services Ltd v Focus Caring Services Ltd & Others* [2014] EWHC 2313 (Ch) which was the first case in which the *Yam Seng* principles were tested in a franchise context. The defendant franchisee tried unsuccessfully to argue that (amongst other alleged implied terms) the franchise agreement contained an implied term that the parties would conduct themselves in "good faith and/or deal with each other fairly and in particular not in a manner that would damage each other's business interests". The judge's conclusion may have been influenced by the

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nine other terms the defendants argued were also implied into the agreement which the judge described as "wide and imprecise" and unnecessary in what was a detailed commercial agreement. The judge in *Carewatch* agreed with the reasoning of the judge in the case of *Hamsard 3147 Ltd (t/a Mini Mode Childrenswear) v Boots UK Ltd [2013] EWHC 3251* (which concerned the termination of a supply agreement between the parties for the supply of children's clothes to Boots stores) who said that he did not regard the *Yam Seng* case as authority for the proposition that there is a general obligation of good faith implied into all commercial agreements or that there is some sort of positive obligation implied that a party to a contract should subordinate its own commercial interests to those of the other contracting party.

The *Carewatch* decision has been analysed with interest and led some commentators to conclude that the *Yam Seng* principles do not apply to franchise relationships. However, it is suggested that is not correct. What the *Carewatch* case does illustrate is that the *Yam Seng* principles will only be applicable in the right case and on the right facts. There were two major problems with the franchisees' arguments in *Carewatch*:

1. They attempted to argue that a number of quite vague obligations were to be implied into the franchise agreement which went over and above an obligation of good faith. Amongst other alleged implied terms, the franchisees argued that the agreement contained an implied term that the parties would conduct themselves in "good faith and/or deal with each other fairly and in particular not in a manner that would damage each other's business interests". The judge's conclusion that there was no such obligation may have been influenced by the nine other terms the franchisees argued were also implied into the agreement which the judge described as "wide and imprecise" and unnecessary in what was a detailed commercial agreement;

2. The franchisees themselves were not coming to court with 'clean hands'. The judge found that they had been running a competing business in parallel with the franchised business for some time. This was a serious breach of the franchise agreement which allowed the franchisor to terminate. An implied duty of good faith will be a mutual one such that both sides must comply with it. A court is not going to find a franchisor to be in breach of an implied duty of good faith in a situation where the franchisee is in blatant breach of a fundamental and express term of the agreement.

In a case with different facts, such as a franchisor who has behaved dishonestly or commercially unacceptably coupled with a franchisee who has complied with its contractual obligations and is very much the 'innocent party', a judge could well be persuaded take a different approach to that taken by the judge in *Carewatch* and is much more likely to follow the *Yam Seng* case to come to the 'right' decision. The *Carewatch* case just reinforces the view already shared by some English franchise lawyers that franchisees cannot expect to be able to cry "Yam Seng" any time their franchisor makes a decision that they do not like. However, they should be able to enjoy protection when they have genuinely been wronged by their franchisor.

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A standard of good faith is taking shape under English commercial contract law. The *Emirates* and *Bristol Groundschool* decisions are just the latest sign of this genuine paradigm shift. By contrast, the *Hamsard* and *Carewatch* decisions illustrate that the concept of good faith has its limitations and courts will not allow contracting parties (such as franchisees) who are treated toughly, but commercially fairly, to use the concept to benefit from rights and protections which the agreement did not give them.

When making a decision which will affect the franchise network as a whole, particularly if it may impact on the value or profitability of the franchisees' businesses, a franchisor needs to ensure that the decision would be viewed as 'commercially acceptable' to an outsider. However, it need not subordinate its own interests to that of its franchisees; as the judge in the *Carewatch* case said "[a franchisor] is free to have regard to its own commercial interests in deciding how to run its franchise business, provided always that it complies with the express terms of its current franchise agreement".

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