

INSIGHTS

Obligations of Good Faith in JOAs - The Impact of Recent Decisions on 'Relational Contracts'

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In the international upstream oil and gas exploration and production industry, joint operating agreements (“JOAs”) are the key agreements which govern the terms upon which oil and gas companies regulate their upstream joint ventures. JOAs often provide for sharing costs and liabilities, allocating production entitlements, making decisions (including very high value decisions to drill wells and develop oil and gas fields), and transfers and assignments. However they can often give rise to disputes, in particular between the operator and the non-operating parties.

English law has traditionally resisted implying an obligation to act in 'good faith' into commercial contracts. However, since 2013, in a number of first instance decisions, the English Courts have implied such a duty into 'relational contracts'. The latest case of [Alan Bates & Ors v Post Office Ltd \[2019\] EWHC 606](#) provides guidance on the types of circumstances in which a contract will be classified as a 'relational contract', which may have the effect of requiring the parties to act in good faith in the performance of their obligations under English law.

In light of these decisions, JOA parties could see arguments on 'good faith' becoming more of a focus in the future. However, whether the English Courts or arbitral tribunals presiding over JOA disputes will accept such arguments remains to be seen.

Good faith in English law

English law has traditionally shunned the implication of a general obligation of good faith¹ in commercial contracts, except in very limited circumstances.² This can be contrasted with the many civil law jurisdictions (and some common law jurisdictions) which acknowledge a general requirement for contractual parties to act in good faith. Since 2013, the English Courts have concluded in a number of cases that a duty of good faith is implied in certain classes of contract, known as 'relational contracts'.

Implication as a matter of fact or law?

Terms can be implied into a contract as a matter of fact or as a matter of law. In deciding whether to imply a term as a matter of fact, the English Courts will consider a number of factors, including whether the term to be implied is necessary to give the contract business efficacy and whether the term is so obvious that it goes without saying.³ A term can also be implied as a matter of law where the contract is found to fall within a certain class of contracts that require such a term to be implied.

Different approaches have been taken in the recent cases. Some have implied a duty of good faith as a matter of fact.⁴ Others have concluded that the contract in question is a 'relational contract' and that consequently a duty of good faith will be implied as a matter of law.⁵ Such contractual interpretation has been met with mixed reception, and generally with some caution. However, if the latter analysis is adopted and a JOA can be said to be a 'relational contract', then a duty of good faith could well be implied into the JOA absent express wording to the contrary.

What is a 'relational contract'?

A 'relational contract' is a special category of contract that may "...involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements".⁶

The [Bates v Post Office](#) decision provided guidance on the specific characteristics that are expected to be present for a contract to be considered a 'relational contract'. The list is not exhaustive, and no single criterion is determinative, with the exception of the first:

1. no express term preventing a duty of good faith being implied;
2. mutual intention of a long-term relationship;
3. intention to act with integrity, and with fidelity to the bargain;
4. commitment to collaborate in the performance of the contract;
5. "spirits and objectives" of the venture may not be capable of being expressed exhaustively in a written contract;

6. parties put trust and confidence in each other, but of a different kind to that involved in fiduciary relationships;
7. a high degree of communication, co-operation and predictable performance based on mutual trust and confidence, and expectations of loyalty;
8. a degree of significant investment by one party (or both) in the venture; and
9. exclusivity of the relationship.

On the face of it, these criteria could apply to many types of commercial contracts. PFI contracts,⁷ franchise agreements,⁸ and joint venture arrangements⁹ have both been found to be 'relational contracts'. However, whether a contract will be classified as a 'relational contract' will be highly dependent on the facts and context - not all PFI, franchise and joint venture arrangements will be 'relational contracts'.

Are JOAs relational contracts?

JOAs are a species of joint venture agreement. However, whether a JOA is to be classified as a 'relational contract' will, as with all agreements, depend on "*the circumstances of the relationship, defined by the terms of the agreement, set in its commercial context*".¹⁰

The party arguing for a duty of good faith might say that the JOA shares a number of characteristics with 'relational contracts'. The party arguing against a duty of good faith might point to the fact that the cases in which a 'relational contract' has been found to exist turn on extreme facts, and that "*very specific characteristics are necessary in order that a commercial contract is categorised as a relational one*".¹¹ Parties will likely also argue that the express provisions of the JOA concerning how the parties are to work together are sufficient to prevent a duty of good faith being implied. Nevertheless, detailed and lengthy contract terms do not of themselves mean that a contract cannot be a relational one.¹² These arguments may be promoted to centre stage in light of the recent development of the concept of 'relational contracts'.

The question of whether a JOA is a 'relational contract' has not yet been determined in a reported decision of the English Courts. Until that happens, it remains unclear whether or not a JOA is a 'relational contract' and whether consequently a duty of good faith should be implied. To avoid a dispute on the issue, the best way to achieve certainty on the good faith obligations of the parties will be to address them expressly. However, this may not be an issue that the commercial parties will wish to address in negotiations.

What is the scope of a duty of good faith in relational contracts?

The obligation of good faith in relational contracts requires the parties to refrain from conduct which would be regarded as commercially unacceptable by reasonable and honest people.¹³ It does not mean solely that the parties must be honest.¹⁴ "*Transparency, co-operation and trust and confidence*" are also "*implicit within the implied obligation of good faith*".¹⁵

Although each case is unique, recent decisions provide the following examples of behaviour that would be inconsistent with a duty of good faith:

1. for one party to agree or enter into negotiations to sell his interest or part of his interest in the companies which they jointly owned to a third party covertly and without informing the other beneficial owner;^{[16](#)}
2. for either party to use his position as a shareholder of the companies to obtain a financial benefit for himself at the expense of the other; and^{[17](#)}
3. to omit or fail to act honestly in the provision of information to the other party.^{[18](#)}

The cases in these examples did not involve upstream oil and gas parties or JOAs. In fact, these decisions were borne out of specific and quite particular circumstances. However, until tested in the English Courts, it is unclear how a duty of good faith would apply to the parties to a JOA and whether it would, in particular, apply to the obligations of both the operator and the non-operators. This will be an issue that will need to be considered by any court or tribunal in considering the implication of a duty of good faith into a JOA.

Conclusion

This is a developing area of law.^{[19](#)} Although there appears to be a move towards implying an obligation of good faith in certain categories of commercial contracts, such a duty will not be routinely implied into all commercial contracts. Importantly, the Courts will not imply a term into a contract which intrudes on or is inconsistent with the parties' express agreement, and will not improve a bad bargain. Whether a contract is a 'relational contract' such that a duty of good faith will be implied is heavily dependent on context. It is the exception, not the rule.

However, the recent cases are likely to encourage arguments around implied obligations of good faith in JOA disputes, with ever more creative arguments being made. The only way to avoid such disputes will be to include express wording specifically addressing good faith at the time the JOA is negotiated.

¹ See for example [Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd \[1988\] 1 All ER 348](#), Bingham LJ at [352-353]

² Good faith duties are incorporated into certain legislation, such as the Sale of Goods Act 1979, s 61(3); and the Bills of Exchange Act 1882, s. 90

³ [Marks and Spencer PLC v BNP Paribas Security Services Trust Co \(Jersey\) Ltd \[2015\] UKSC 72](#)

⁴ For example, [Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayay v Ioannis Kent \[2018\] EWHC 333](#)

⁵ [Alan Bates & Ors v Post Office Ltd \[2019\] EWHC 606](#)

⁶ [Yam Seng Pte Ltd v International Trade Corp Ltd \[2013\] EWHC 111](#) at [142].

⁷ [Amey Birmingham Highways Ltd v Birmingham City Council \[2018\] EWCA Civ 264](#)

⁸ *Yam Seng* (ibid)

⁹ The *Al Nehayan v Kent* (ibid) and [*Bristol Groundschool Ltd v Intelligent Data Capture Ltd \[2014\] EWHC 2145*](#) case are two such examples.

¹⁰ *Bates v Post Office* at [721]

¹¹ *Bates v Post Office* at [727]

¹² See [*Amey Birmingham Highways Ltd v Birmingham City Council \[2018\] EWCA Civ 264*](#), per Jackson LJ at [93]

¹³ *Bates v Post Office* at [711]; *Yam Seng* at [144]

¹⁴ *Bates v Post Office* at [710]; [*D&G Cars Ltd v Essex Police Authority \[2015\] EWHC 226 \(QB\)*](#) at [175]

¹⁵ *Bates v Post Office* at [738]

¹⁶ *Al Nehayan* at [176]

¹⁷ *Al Nehayan* (ibid)

¹⁸ *Yam Seng* at [172]

¹⁹ The Post Office has lodged an application at the Court of Appeal for permission to appeal the *Bates v Post Office* judgment.