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NEW BALANCE FAILS TO EQUALISE IN SPONSORSHIP DISPUTE

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SUMMARY

In a step change from the days of Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest) in which the Court of Appeal rejected the notion of a general doctrine of good faith, many construction contracts now include an express requirement to act in "good faith".

This trend is not confined to long term PPP agreements and alliancing arrangements. It is also seen in standard form contracts, such as the "mutual trust and co-operation" wording found in the NEC ECC contracts and (where selected) the supplemental collaborative wording found in the JCT:

> "…the parties shall work with each other and with other project team members in a collaborative and co-operative manner, in good faith and in a spirit of trust and respect…".

Commercial practitioners will also be aware of the recent judicial focus on relational contracts, into which contracts a duty of good faith may be implied. Last year the Court of Appeal noted that a PFI contract may be classified as a relational contract in Amey Birmingham Highways Ltd v Birmingham City Council.

However, until Bates v Post Office Ltd (No.3), there had been comparatively little judicial guidance as to how to determine what the parties meant when they promised to act in "good faith". In Bates, Mr Justice Fraser held the duty of good faith to mean that:

> "*the parties must refrain from conduct which in the relevant context would be regarded as commercially unacceptable by reasonable and honest people…*"

(and not solely that the parties must be honest). He provided a list of factors to assist identification of a relational contract, although he didn't give much concrete guidance on the practical scope of the "good faith" obligation. This is why the recent case of New Balance Athletics, Inc v Liverpool

Football Club and Athletic Grounds Ltd is particularly interesting as, post-Bates, the court considered in detail what an implied duty of good faith might mean in practice.

What happened

The case concerned the renewal of a sponsorship agreement between New Balance Athletics and Liverpool Football Club. Liverpool was obliged to negotiate first with New Balance in relation to the agreement's renewal (the first dealing period). If no agreement was reached during the first dealing period, Liverpool could enter into negotiations with a third party. However, if those negotiations with a third party resulted in an offer, New Balance had the right to match that third party's offer. If it chose to do so, Liverpool would be obliged to enter into a new contract with New Balance.

The contract contained an express obligation requiring the parties to negotiate during the first dealing period in "good faith". Although this did not expressly extend to the matching of the third party offer, the parties agreed that this process should also be subject to the "good faith" proviso. But they could not agree what this implied good faith obligation actually involved.

The crux of the dispute concerned New Balance's claim that it had matched the third party's offer. Liverpool disagreed, saying that New Balance's offer was not genuine and nor was it capable of matching the third party's offer. New Balance issued proceedings and the issue before the court (whether New Balance had matched the third party offer) was broken down into two questions:

- Had New Balance's offer been made in good faith?
- Did it match the third party's offer?

On the first issue both parties agreed that New Balance was required to act in good faith, but differed as to what that entailed. New Balance argued that it would only be in breach of the implied term of good faith if it did not intend to meet, or knew that it could not meet, the terms of its offer. Liverpool disagreed, arguing that the duty was breached if New Balance had no reasonable grounds to believe it could meet or knew that it could not match the offer; or did not otherwise care whether it could do so.

The decision

After a detailed comparison of the offers, Mr Justice Teare ruled that Liverpool were entitled to enter into the contract with the third party on the basis of the second issue – because New Balance's offer did not match that of the third party. However, more interestingly for practitioners, he determined that New Balance **had acted in good faith**.

In determining what the implied duty of good faith meant in practice, he said it was clear that the duty of good faith could be breached not only by dishonesty but also by "conduct which lacks fidelity to the parties' bargain…".

Mr Justice Teare explained that whether the parties had been faithful to their bargain would include consideration of the nature of the bargain, the contract terms and the context in which the matter had arisen. Ultimately, he concluded, the question was whether:

> "*reasonable and honest people would regard the challenged conduct as commercially unacceptable*".

Interestingly, he considered that internal due diligence carried out by New Balance to assess its capability to match the third party offer demonstrated that it was actively concerned with ensuring it could deliver it. Therefore New Balance had not been reckless (as Liverpool had argued) and although the failure of certain New Balance staff to confirm the results of the due diligence may have been imprudent, this was not indicative of bad faith.

Analysis

Some have billed this case as providing a post Bates clear-cut test for what an implied duty of good faith may involve. However, this is no clear-cut test. Nor is it new law.

It is settled law that when one considers how an implied term should operate, one should consider factors such as the nature of the bargain, the contract terms and the context of the matter. It is also nothing new to say that how an implied term operates should be considered from the viewpoint of "notional reasonable people in the position of the parties at the time at which they were contracting" (Marks and Spencer v BNP Paribas).

It is unsurprising that the court has not provided clear guidance for what it means to act in "good faith". A nebulous concept such as "good faith" will be by definition fact-specific; what "good faith" means to one set of contracting parties will not necessarily be what it means to another. It should not be defined by a road map of the sort used for contract interpretation or implication of terms. The question as to whether reasonable and honest people would regard the challenged conduct as commercially unacceptable allows for the context of the matter to inform the conclusion, and we should not expect much, if any, deviation from this flexible test.

Final thoughts

The key message from New Balance is that if you include an express obligation of good faith in your contract, then make sure you agree with the party that you are contracting with exactly what this means and then make sure the contract records it. Further, if the parties want the ability to verify that certain contractual steps have been carried out accurately, they should include appropriate mechanisms in the contract (for example, audit or disclosure requirements).

For all longer term contractual relationships, whether a good faith obligation is express or implied (for example, by virtue of an agreement being categorised as relational), the parties should be alive

to the requirement to conduct themselves in a manner likely to be regarded as “commercially acceptable” throughout the lifecycle of the contract.

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