

## KEY POINTS

- Good faith is an umbrella term for a small range of specific implied terms.
- They include terms which have the dual aims of ensuring that parties deal honestly with each other in performing the contracts and stay loyal to the bargain.
- Uncertainty in assessing the existence and scope of the implied term is inherent in its fictional nature.
- There are two ways in which the uncertainty flowing from *Yam Seng* can be reduced, if not removed altogether.

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# An implied term of good faith: a watershed or a damp squib?

The recent decision of the High Court in *Yam Seng Pte Limited v International Trade Corporation Limited* [2013] EWHC 111 (QB) has opened the door to an implied duty of good faith in commercial contracts. The decision, its impact on certainty and implications for the future are discussed below.

Traditionally English law has been reluctant to accept a role for good faith in English contract law. As Bingham LJ observed:

"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 not deceive each other... It is in essence a principle of fair open dealing ... English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness" (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433 at 439).

In the couple of decades since that seminal decision, the traditional view has come under increasing pressure from both the more widespread recognition of duties of good faith in common law jurisdictions and from the use of good faith terminology in EU-derived English legislation, eg the Unfair Terms in Consumer Contracts Regulations 1999. The decision in *Yam Seng* will be seen by many as the natural culmination to these pressures.

## YAM SENG: THE FACTS

The dispute was over a distribution contract between Yam Seng Pte Ltd (Yam Seng) and International Trade Corporation Ltd (ITC) dated 12 May 2009, pursuant to which Yam Seng was granted certain exclusive rights to distribute Man Utd fragrances and

complementary products. The rights were mostly limited to duty free sales rather than domestic sales.

The contract was due to run until 31 December 2011 but was terminated in July 2010 by Yam Seng who alleged, amongst other things, that ITC was in breach of contract for undercutting agreed retail prices and providing false information.

## THE DECISION

After turning to these two complaints, Leggatt J held that on the facts of this case there were two relevant implied terms:

- an implied duty of honesty in the provision of information by ITC to Yam Seng; and
- an implied duty not to approve a domestic retail price for a product which undercut the duty free retail price.

The breach of the former was a repudiatory breach which entitled Yam Seng to terminate the contract. On the evidence there was no breach of the latter duty.

It is the reasoning behind these two implied terms which gives rise to the interest and controversy. Both terms were said to represent "the relevant content of the duty [of good faith] in this case" (at para 154).

## THE TRADITIONAL VIEW

The Judge reviewed English law's approach to a general principle of good faith at some length. There were three main reasons for refusing to acknowledge any doctrine of good faith:

- The preferred method of English law was not to adopt a general overarching principle but to develop incrementally with piecemeal solutions.
- English law valued individualism whereby parties were left to pursue their own self-interest in negotiating and performing contracts (provided they do not breach the terms of the contract).
- The doctrine of good faith would undermine certainty in contract law.

Notwithstanding these objections, the Judge observed that English law "would appear to be swimming against the tide". A contrast with other civil and common law jurisdictions was drawn. Further, it was clear that English law did recognise good faith in certain areas, such as in EU-derived legislation and in certain categories of contract, eg, employment contracts (*BCCI SA v Malik* [1997] UKHL 23) and fiduciary relationships.

## THE DEVICE: THE IMPLIED TERM

The Judge ruled out a duty of good faith implied by law in to commercial contracts. However, there was said to be no difficulty in a duty of good faith implied *in fact*.

The two standards tests for implying terms in fact are: the term is so obvious that it goes without saying, and the term is necessary to give business efficacy to the contract. More recently, it has been emphasised that implied terms are part of the process of construction of the contract as a whole (*Attorney General for Belize v Belize Telecom Ltd* [2009] 1 WLR 1988 at 1993–5). The ultimate question is what would the contract, read as a whole against the relevant background, reasonably be understood to mean?

The Judge reasoned that part of the relevant background includes shared values and norms of behaviour which may be



## Feature

### Biog box

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generic to society or specific to a particular commercial activity or relationship. A key aspect of good faith was said to be the observance of these standards.

### THE GOOD FAITH STANDARDS

So what are these shared values and norms of behaviour? The Judge postulated two such shared values and norms:

- **Honesty in performance:** This was said to be an expectation underlying almost all contractual relationships. It also extended to bad faith conduct, called variously "improper", "commercially unacceptable" or "unconscionable" conduct.
- **Fidelity to the parties' bargain:** This was said to overlap with the first value. Contracts cannot provide for every eventuality and must be given a reasonable construction which promotes the values and purposes expressed or implicit in the contract.

But what do honesty in performance and fidelity to a parties' bargain actually require? The Judge's answer was:

- It *always* prohibits a party knowingly making a false statement of fact intending that other person to rely on it.
- *Frequently* it will require a party to correct information which has been provided to the other party with the intention of that party relying on it, where that information was believed to be true at the time it was given but has subsequently been discovered to be untrue.
- *Depending on the context* it prohibits a party from deliberately avoiding giving an answer or giving an answer which is evasive in response to a request for information.
- In "*relational*" contracts, such as joint venture agreements, franchise agreements and long term distributorship agreements, it *may* positively require parties to share information relevant to the performance of the contract.

On the facts ITC was in repudiatory breach of contract in failing to comply with the first criterion. It was with obvious reluctance that the Judge disavowed any determination on the fourth criterion on the basis that such a positive obligation did not

form part of Yam Seng's pleaded case.

### UNCERTAINTY

The Judge identified three reasons for the traditional reluctance of English contract law to recognise a duty of good faith. Of these, the most significant for commercial parties is surely the risk of uncertainty. So has *Yam Seng* created uncertainty in English contract law? The answer is more nuanced than detractors may suggest.

### THE CONTENT OF A DUTY OF GOOD FAITH

Few can doubt that the decision has taken strides towards attributing content to an implied duty of good faith. There are variants of a duty of good faith: a duty of honesty in performance and a duty of fidelity to the bargain. The Judge then set out four sub-categories (see above) of duties of honesty which also seem intrinsically linked to the duty of fidelity to the bargain.

Thus good faith is not an open-textured concept which means everything and nothing at the same time. Rather, it is an umbrella term for a small range of specific implied terms which have the dual aims of ensuring that parties deal honestly with each other in performing the contracts and stay loyal to the bargain.

### THE APPLICATION OF A DUTY OF GOOD FAITH

The problem is ascertaining when a duty of good faith applies in any particular case, and if so, which type. Uncertainty flows predominantly from the use of the implied term as a device for introducing good faith into English contract law.

It is of course trite that an implied term in fact, seen as part of the general process of construction of the contract, is a term which the parties *objectively* intended. It reflects the *presumed* intention of the parties only. Uncertainty in assessing the existence and scope of an implied term is accordingly inherent in its fictional nature.

*Yam Seng* increases that uncertainty by introducing the concept of "shared values and norms of behaviour" as part of the relevant background against which a contract is

construed and terms are implied. The added element of ambiguity lies in determining what those shared values and norms will be in any one case.

Furthermore, *Yam Seng* makes it plain that the question is not a binary one, ie, whether there is an implied term of good faith or not. Rather it is a question of whether, and if so which, implied term of good faith applies.

The obvious consequence of this uncertainty is that it will be more difficult for legal representatives to advise upon the likely construction of a contract or outcome of a particular dispute. On a more practical level, it will also leave a party less sure of their rights in the face of perceived bad behaviour by another party.

### THE WAY FORWARD

There are two ways in which the uncertainty flowing from *Yam Seng* can be reduced, if not removed altogether. The first is to draft the contract so as to exclude any duty of good faith. This was expressly condoned in *Yam Seng* although considered an unlikely option.

The second is to limit the *Yam Seng* duties to the immediate parties to so-called relational contracts. There are convincing arguments in favour of this course. Franchise, joint venture and distributorship agreements usually involve long-term relationships, a substantial commitment from the parties and often a common goal. These features, normally absent in "simple exchange" or "zero sum" contracts, may well justify the Court's starting premise of fidelity to the parties' bargain.

As things stand, there is a real possibility that an implied duty of good faith will be imposed into traditional commercial contracts. *Yam Seng* suggests that there will *always* be a duty not to provide knowingly false information in the performance of the contract. It also seems likely that Courts will be more receptive to an argument that, in relational contracts, the more extensive duty to positively share information should apply. It remains to be seen whether a Court will go so far as to imply such a positive duty into a finance contract on the basis that the financier is engaged in a joint operation.