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Contract Corner:

A review of typical contracts and clauses

Issue 05, 2013

Can you imply good faith into agreements made under English Law?

This issue's contract corner discusses good faith.

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Good faith might be a strange topic to find in contract corner, especially one written by an English lawyer. However, the recent case of *Yam Seng Pte Ltd (a company registered in Singapore) v International Trade Corporation Ltd*¹ suggests that there may be a small change in the approach of the English courts to the question of whether or not English law does or should recognise a general duty to perform contracts in good faith. The general view is, of course, that traditionally under English contract law there is no legal principle of good faith. Two reasons for this are said to be found, the first in the general principles of freedom of contract whereby parties are free to pursue their own goals in both negotiating but also in performing contracts provided they do not act in breach of a term of the contract. Second there is concern that the concept of good faith is too vague and subjective and therefore uncertain.

As Mr Justice Legatt noted, this approach, in refusing to recognise any such general obligation of good faith, would appear to be an example of "swimming against the tide" of both civil and common law jurisdictions. Good faith appears in most civil codes and, for example, in Australia the existence of a contractual duty of good faith is reasonably well established.² The Judge concluded that he doubted that English law had reached the stage, however, where it was ready to recognise a requirement of good faith as a duty implied by law, even as a default rule, in all commercial contracts. However, the Judge

further noted that there seemed to him to be no difficulty in adopting the established principles of English law for the implication of terms in fact, depending on the facts of course, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties.



Under English law, the two basic and principal criteria used to identify terms implied in fact are that the term is so obvious that it goes without saying and that the term is necessary to give business efficacy to the contract. What would the contract, read as a whole against the relevant background, reasonably be understood to mean? In the case here, the Judge noted that the relevant background was important, not only in terms of matters of fact known to the parties but also shared values and norms of behaviour. These may include norms that command general social acceptance or that may be specific to a particular trade, commercial activity or even the particular contractual relationship in question. The Judge stressed that commerce takes place against a background expectation of honesty. Such an expectation is essential to commerce, which depends critically on trust. However, as he adroitly recognised,

such an expectation is seldom, if ever, made the subject of an express contractual obligation. To seek to do so might actually damage the parties' relationship by the lack of trust that this would signify. The Judge concluded that as a matter of construction, it would be hard to envisage any contract

which would not reasonably be understood as requiring honesty in its performance.

There were also other similar standards of commercial dealing which are so generally accepted that the contracting parties would reasonably be understood to take them as read without explicitly stating them in their contractual document. The Judge had in mind the concept of "fidelity to the parties' bargain".

Contracts can never be complete in the sense of expressly providing for every event that may happen. To apply a contract to circumstances not specifically provided for, the language must accordingly be given a reasonable construction which promotes the values and purposes expressed or implicit in the contract.

Mr Justice Legatt stressed that what good faith requires is sensitive to and depends on context. That includes the core value of honesty. Some contracts, including joint venture agreements, may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence, 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. The case at hand involved a long-term distributorship agreement

1. [2013] EWHC 111 (QB)

2. The Judge's judgment provides a useful summary of the position worldwide.



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which required the parties to communicate effectively and cooperate with each other in its performance.

This led the Judge to conclude that there was in his view nothing novel or foreign to English law in recognising an implied duty of good faith in the performance of contracts. He referred to the body of cases in which duties of cooperation in the performance of the contract have been implied and the authorities which show that a power conferred by a contract on one party to make decisions that affect them both must be exercised honestly and in good faith for the purpose for which it was conferred, and not arbitrarily or unreasonably. Another example is that frequently found in a construction context where the consent of one party is needed to an action of the other and a term is implied that such consent is not to be withheld unreasonably.

To the Judge, the essence of contracting is that the parties bind themselves in order to co-operate to their mutual benefit. The obligations that they undertake include those which are implicit in their agreement as well as those which they have made explicit. Further, the Judge saw no objection in describing the duty as one of good faith "and fair dealing". Such a duty does not involve the court in imposing its view of what is substantively fair on the parties. What constitutes fair dealing is defined by the contract and by those standards of conduct to which, objectively, the parties must reasonably have assumed compliance without the need to state them. The inclusion of fair dealing would draw attention to the fact that the standard is objective. As such there should be nothing unduly vague or unworkable about the concept. The application involves no more uncertainty than is inherent in the process of contractual interpretation. This is important because, in the Judge's view, the content of the duty is heavily dependent on context and

is therefore established through a process of construction of the contract, in other words on the typical English case-by-case approach.

In conclusion Mr Justice Legatt said this:

"In the light of these points, I respectfully suggest that the traditional English hostility towards a doctrine of good faith in the performance of contracts, to the extent that it still persists, is misplaced."

In the case here, it was said that the relevant duty was captured by two more specific terms which Yam Seng argued were to be implied into the Agreement. These were (i) the duty not to give false information and (ii) the far more specific duty not to undercut duty free prices. The problem with the first



issue was the failure to distinguish between encouraging expenditure in the expectation that products would be supplied by providing false information dishonestly, and doing so innocently. To lead a party to expect that products were going to be supplied, believing that you would be able to supply them and were intending to do so, would not show a lack of good faith. However, if you wilfully led another to expect that products would be supplied in circumstances where you either did not intend to supply them or knew that you would be unable to do so, would be contrary to standards of commercial dealing. The second term was factually specific to the case in question although the Judge noted that the usual reasonable commercial expectation would be that a party would

be free to sell its products to others on such terms as it chose unless it had expressly agreed otherwise. However, on the facts, the term was implied into the agreement between the parties.

This led the Judge to imply two terms into the agreement, the implied duty of honesty in the provision of information and the implied duty not to approve a domestic retail price for a product which undercut the duty free retail price. On the facts, the Defendant was found to be in breach of the first term.

Conclusions

We have highlighted this case because of the careful and clear comments made by Mr Justice Legatt about the implication of good faith into agreements made under English law. Clearly he is not saying that you would be able to imply good faith into each and every agreement. It all depends on the context of the contractual arrangements made between the parties. However, the Judge has potentially opened a pathway which others will follow and which suggests that perhaps English law is not so different, in this context, from other jurisdictions. No doubt this is a development that will be watched with interest and which will feature in future editions of *IQ*.

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