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The *Yam Seng* case and its aftermath: possible directions of good faith in contract law.

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The purpose of this paper is to consider the influence of the *Yam Seng*<sup>1</sup> case on the reception of good faith in English contract law. The *Yam Seng* case is a landmark case because the principle of good faith is considered eminently suitable for implication in the performance of a contract. Whilst the principle of good faith is considered a fundamental principle in the civil law system in Europe, it has not been so accepted in English common law. In the *Yam Seng* case good faith is fully discussed for the purpose of including it in English contract law. The concluding remark of the Judge is 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.’<sup>2</sup> The case is considered by Hugh Collins as an overt reference to the notion of good faith and fair dealing as the third ground for implied terms under Article 6:102 of the Principles of European Contract Law (PECL).<sup>3</sup> In other words, the *Yam Seng* case is relevant in European contract law. The case is also perceived to have established a firm basis towards reception of good faith; the Chief Justice of Singapore, Sundaresh Menon, CJ who was comparing the Singapore courts response to good faith with the English courts, said that in the light of the *Yam Seng* case, ‘the English courts seem poised to take on a more absolute position.’<sup>4</sup>

The decision of the case is significant, when seen against some of the authoritative opinions expressed on the subject at that time. In the *Walford*<sup>5</sup> case, the highest court of the land in Britain had expressed in robust language that good faith is too vague and uncertain to have a role in English contract law. A similar view was expressed by Professor Roy Goode:<sup>6</sup>

There are several reasons why English law has been reluctant to embrace a generalised concept of good faith. In the first place, we do not quite know what the concept means. Is it, for example, contrary to good faith to negotiate concurrently with several parties in relation to the same contract without disclosing that fact to each of them? Or to exercise a contractual right to terminate a contract when this would cause hardship to the other party? Or to sell a house without disclosing structural defects? The concern engendered by open-textured rules such as a duty of good faith is, perhaps, not entirely unjustified when one considers the huge volume of litigation generated by section 242 of the German Civil Code, the principal source of the duty of good faith in German contract law which has provided the foundation for the creation or elaboration of a whole network of contractual theories, including *culpa in contrahendo*, *clausula rebus sic stantibus*, contracts for the benefit of third parties, and the duty to provide information needed to invoke rights.

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<sup>1</sup> *Yam Seng Ltd (accompany registered in Singapore) v International Trade Corporation Ltd* [2013] EWHC 111 (QB)

<sup>2</sup> *Yam Seng*, per Leggatt J at [154]

<sup>3</sup> Hugh Collins “Implied Terms: The Foundation in Good Faith and Fair Dealing” (2014) *Current Law Problem* Vol 67 at 300.

<sup>4</sup> Sundaresh Menon, CJ “The Somewhat Uncommon Law of Commerce” (2014) 26 *SAC LJ* at 40.

<sup>5</sup> *Walford and others v Miles and others* [1992] AC 128.

<sup>6</sup> Roy Goode “International Restatements of Contract and English Contract Law” (1997) *Unif Law Rev.* at 239-240

In view of the above, the main purpose of this paper is to discuss what the *Yam Seng* case has established and to assess its effect on English contract law. In particular, it will consider whether the case has provided a basis or a new direction for the English courts on the subject. To that end, this paper will look at some of the court cases following the *Yam Seng* case. As the focus of this paper is on the *Yam Seng* case which is a case on the performance of contract, it will not consider the wider application of good faith in the other aspects of contract, like the formation of contract or contractual remedies.

The thesis of the paper is the *Yam Seng* case has done several things to accommodate the notion of good faith in English contract law. Foremost of the things done, is that it provides a rational basis which is consonant with the principles and norms that have governed English contract law. Secondly, the case has provided a modus operandi for the inclusion of terms of good faith into commercial contracts. It suggests a methodology based on the rule of implication in contract. Thirdly, it has teased out some of the underlying ideas in English law to suggest “models” for a general application of good faith for all commercial contracts. It has suggested a model of honesty as the main incident of good faith applicable to all contracts. It has also suggested a certain category of relational contract, which is eminently suitable to include the rule of good faith. I suggest that in the production and assembly of cars as a production regime, good faith could provide the facilitative factor for the industry.

It is also my thesis that cases after *Yam Seng* indicate that good faith has been widely invoked as a possible solution to a wide range of issues in contracts. The judicial response is that the *Yam Seng* case has not postulated a general principle of good faith. The critical factor for the judiciary in the *Yam Seng* case is the application of the duty of good faith is ‘sensitive to context.’<sup>7</sup>As a result, the principles which are elicited in each of the cases are specific to the facts of the case. Those principles could not be easily systematised into a more general principle.

Whilst there are issues raised in the methodology itself, the courts are not perturbed by the issues. They approach the cases with a practical wisdom of whether it is appropriate to apply good faith or not. Their decisions suggest some defined patterns of directions for good faith. Cases where discretion is given to one party that could determine the outcome of a contract, the courts would not import good faith to give it a wider meaning. Similarly, cases where good faith provisions are set out as expressions of the ethos of the transaction, the courts would construe it restrictively to the specific circumstances of the relevant provisions. Another kind of transactions which the courts deemed it unsuitable for good faith principle to apply is financial transaction. This thesis suggests in financial contract, the rule of good faith would be a more appropriate rule to provide an ethos of trust, which is sorely needed in the financial market.

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<sup>7</sup> *Yam Seng*, at [141]

The final part of my thesis relates to the way the notion of good faith was invoked by a New Zealand judge, in the person of Thomas J. Good faith was introduced when considering the issue of interpretation of certain terms in the contract. Thomas J's decisions on good faith raise two issues: (a) whether it is legitimate to import good faith in the interpretation of contract and (b) what is the status of such a decision in terms of precedents. My thesis is that such an approach, not considered under the rule of implied terms, would open the door to unbridled judicial activism and might be regarded as intrusive to contractual relationship. The status of Thomas J's decision on the topic in the context of the issues raised is at best an obiter opinion.

The proposed methodology to establish the above thesis is as follows:

- Firstly, at Part II of the paper, it will consider the *Walford* case as it encapsulates the English courts objection to the notion of good faith in English law prior to the *Yam Seng* case. The English concept of contract law is briefly discussed to show why it finds the notion of good faith uncertain or vague.
- Next, in Part III of the paper, it will discuss the *Yam Seng* case. Broadly the discussion will identify the three main points mentioned above, namely, (a) the rational basis for good faith, (b) the methodology for the inclusion of good faith which is based on the law of implication in fact (the subtext to this is the class of relational contracts which is identified as eminently appropriate to imply the notion of good faith) and (c) whether the case has postulated a model of honesty which could be applicable to all commercial contracts.
- Part IV of the paper will then consider some of the cases after *Yam Seng* to determine the nature of the influence of the case on the subject. The cases will show the wide range of issues which the notion of good faith is invoked as a solution. Whilst the English judges are anxious to state that the *Yam Seng* case does not introduce a general principle of good faith, there are certain principles set out from the cases and also certain directions in the kind of cases which the principle could or could not apply.
- The final Part V of the paper will look at the three cases which Thomas J had discussed the notion of good faith: the *Livingstone*<sup>8</sup> case, the *Bobux*<sup>9</sup> case and the *Wholesale*<sup>10</sup> case and will draw some conclusions from the cases.

The final point of this Introduction is to briefly explain why the English courts decisions on the subject is relevant to international commercial law. The English courts, and by extension English contract law, have been widely resorted to in international commercial disputes.<sup>11</sup> The question is: why this is so? It is a question which was considered by Ewan

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<sup>8</sup> *Livingstone v Roskilly* [1992] 3 NZLR 230.

<sup>9</sup> *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002] 1 NZLR 56.

<sup>10</sup> *Wholesale Distributors Ltd v Gibbon Holdings Ltd* [2007] NZSC 37.

<sup>11</sup> See Jack Beatson and Daniel Friedman "Introduction: From 'Classical' to Modern Contract Law" in Jack Beatson and Daniel Friedman *Good Faith and Fault in Contract Law* (OUP, Oxford, 1995) at 4; Roy Goode

McKendrick as part of the discussion on good faith at a symposium held in Aberdeen University in 1998. He regards this as an important issue in the debate even though he is unable to provide an answer with confidence as there is no empirical evidence available to attempt an answer.<sup>12</sup> But Roy Goode has suggested an answer, pointing to the quality of the judgement of the English judges:<sup>13</sup>

The only reason our commercial law continues to enjoy regard, both here and abroad, is because of the quality of our judges, their sensitivity to legitimate commercial needs and their receptiveness to new legal instruments and concepts fashioned to serve those needs. As an American professor once remarked to Lord Wilberforce:

“The elegance, style and analytical powers of the British legal community have survived the decline of the British Empire intact.”

For this reason, the English judges’ approach on the accommodation of good faith to contract law is relevant in international commercial law and merits serious consideration. The introduction of the common law concept of implied terms under Article 6:102 in PECL has made the English judicial discussion on the subject of relevant interest to a European audience.

## *II Walford case and English contract law.*

### *A At the House of Lords*

In the *Walford* case, the Law Lords in the House of Lords were faced with the issue of good faith in respect of an oral agreement in a negotiation for the sale of a company by the parties. It was pleaded that to give effect to the business efficacy of the oral agreement, it was implied that the parties would continue to negotiate in good faith. As matters turned out, the seller of the company did not continue to negotiate with the buyer as per their oral agreement because it contracted to sell the company to a third party. It was decided that there was no valid pre-contract to negotiate in good faith between the parties and so the seller could enter into a contract with the third party.

There are two aspects to the pre-contractual arrangement between the parties. On one hand, it was a lock-out agreement and on the other hand, it was a lock-in agreement. In a lock-out aspect of the agreement, a party is precluded from negotiating with any other party but does not require him to negotiate with the other party in the lock-out arrangement. In a lock-in part of the agreement, it requires parties to negotiate with each other with a view to reaching the agreement.

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“Insularity or Leadership? The Role of the United Kingdom in the Harmonisation of Commercial Law” (2001) 50 Int’l & Comp LQ at 761.

<sup>12</sup> Ewan McKendrick “Good Faith: A Matter of Principle?” in Angelo DM Forte (ed) *Good Faith in Contract and Property Law* (Hart Publishing Oxford and Portland, Oregon, 1999) at 52-53.

<sup>13</sup> Roy Goode, above n 11, at 761.

On the facts of the case, the House of Lords held that the lock-out part of the agreement is unenforceable as the time of negotiation was not fixed. There is no issue with this part of the decision. It is the conclusion to the lock-in aspect of the agreement which is problematic. Lord Ackner, delivering the decisions of the House of Lords, gave two reasons for refusing to recognise the validity of an obligation to negotiate in good faith. The first reason is that such an agreement is uncertain being 'agreement to agree.' But the second reason is relevant to our discussion, namely that a duty to negotiate in good faith was 'inherently repugnant to the adversarial position of the parties involved in negotiations.' To impose such a duty was 'inconsistent with the position of a negotiating party.'<sup>14</sup>

Lord Ackner's reasoning reveals the operating principle in English contract law and also his concerns with the notion of good faith. The relevant parts of his decisions, state as follows:<sup>15</sup>

How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined 'in good faith'. However the concept of duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations.

It is the communitarian notion of good faith which is inherently repugnant or inconsistent to the principle of freedom of contract in English contract law. Freedom of contract in English contract law means - on one aspect, it is the creative power of parties through contract to act as private legislators and to legislate rights and duties binding upon themselves. The other aspect is the freedom from obligation unless consented to and embodied in a valid contract. <sup>16</sup>

There is also an issue which is not addressed in the *Walford* case which is the seller of the company had negotiated in bad faith, which raises the question as to whether there should be a remedy on this issue. Had the notion of good faith been considered, some form of remedy would be proposed to this issue. This point is made by Lord Steyn, writing extra – judicially in *Contract Law: Fulfilling the Reasonable Expectations of Honest Men* (1997) 113 LQR.<sup>17</sup>

Lord Ackner also referred to the dissenting judgement of Lord Bingham at the Court of Appeal which had held in favour of the buyer of the company. <sup>18</sup>Unfortunately he did not give sufficient consideration to Lord Bingham's views which had suggested that the notion of good faith was workable.

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<sup>14</sup> *Walford*, above n 5, at 7(LexisNexis)

<sup>15</sup> *Walford*, at 7 (LexisNexis).

<sup>16</sup> Beatson and Friedman, above n 11, at 8.

<sup>17</sup> Ewan McKendrick *Contract Law. Text, Cases And Materials* (6<sup>th</sup>ed, OUP, Oxford,2014) at 497.

<sup>18</sup> *Walford*, at 8 (LexisNexis).

## *B At the Court of Appeal*

At the Court of Appeal, Lord Bingham held that there was a contract to negotiate in good faith by the parties. He justified his decision on the following grounds:<sup>19</sup>

- Firstly, he rejected the legal submission that the concept to negotiate in good faith was conceptually impossible. Apart from reference to legal propositions from precedents, he also mentioned other jurisdictions which would consider such a contract be valid. He went on to demonstrate how it could work regardless no time limit was fixed for the period of negotiation. The issue would have to be determined not what the parties had disagreed but on whether there was an impasse in the relationship or conduct which indicated a party had aborted the negotiation through some ulterior motive. Lord Bingham accepted that it would be an issue difficult to decide but it would be a matter no more difficult than the usual cases which fell upon the courts to decide.
- Secondly, he suggested the proposition that where the commercial parties have expressly agreed to negotiate in good faith, the common law response should be to uphold such agreement.

To summarise, whilst there is authoritative statement against the possible reception of good faith in *Walford*, there is also an emerging awareness of a principle of law from another jurisdiction which system of law could provide an appropriate solution, consonant with the expectation of commercial transactions. The robust language of Lord Ackner against the notion of good faith could well be an initial judicial response and it is a matter of time upon matured reflection on the subject that the English judges would come round to accepting it. The important question is, when the time comes to accepting it, how is it done? To this question the *Yam Seng* case is discussed in the next section of this paper.

## *III The Yam Seng case*

### *A The facts and issues*

The facts of the *Yam Seng* case which raised the issue of good faith were as follows:

- An English company (ITC) and a Singapore company (Yam Seng) entered into a distributorship agreement which granted the latter the exclusive rights to distribute certain fragrances bearing the brand name “Manchester United” in specified territories in the Middle East, Asia Africa and Australasia. The rights were for the most part limited to duty free sales.
- Unknown to Yam Seng at the time of the agreement ITC did not have the licence to grant such rights to Yam Seng. Furthermore, the distributorship agreement was a

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<sup>19</sup> *Walford and others v Miles and anor* [1991] 27 EG 114, at 8-9(LexisNexis).



short document containing eight short clauses. They merely set out the essentials for a distributorship agreement.

- ITC was unable to deliver to Yam Seng the product on time. In addition, it further permitted the price of its product in the domestic market of those agreed territories to be sold at a lower price than the price arranged with Yam Seng for the product sold at duty free locations.
- Yam Seng terminated the distributorship agreement alleging that there was repudiatory breach of contract by ITC. It then sued ITC for breach of contract and misrepresentation and claimed for damages.

The issues raised in Yam Seng's claim could be classified as follows:

- Firstly, whether there was a failure to deliver the products promptly.
- Secondly, whether there was a duty not to give false information
- Thirdly, there was a duty not to undercut duty free prices.

It is the second and third issues which raise the point about the duty of good faith. Leggatt J, held there was such a duty of good faith implied in the agreement. His discussion on the subject is considered under three headings: the rationale for good faith is consonant with the principles and norm of English contract law, the methodology for its inclusion, and whether it has postulated a model of honesty applicable in all commercial contracts.

#### *B Rationale for good faith in English contract law*

Whilst acknowledging the influence of the civil concept of good faith in English common law because of United Kingdom's membership in the European Union, Leggatt J considers it is also a concept which is 'nothing novel or foreign to English law.'<sup>20</sup> There is a theme in the English contract cases which is influenced or shaped by the notion of good faith. The theme was identified by Lord Steyn in *First Energy*<sup>21</sup> case, when he said:

A theme that runs through our law of contract is that the reasonable expectations of honest men must be protected. It is not a rule or a principle of law. It is the objective which has been and still is the principle moulding force of our contract law. It affords no licence to a judge to depart from binding precedent. On the other hand, if the prima facie solution to a problem runs counter to the reasonable expectations of honest men, this criterion sometimes requires rigorous re-examination of the problem to ascertain whether the law does indeed compel demonstrable unfairness.

It is this theme which has brought about a certain 'body of cases':<sup>22</sup> cases which require greater cooperation and communication; cases where discretion is conferred on one party that would affect both parties; and cases where particularly onerous or unusual terms are to

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<sup>20</sup> *Yam Seng*, above n 5, at [144]

<sup>21</sup> *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] 2 Lloyd's Report 194, at 196.

<sup>22</sup> *Yam Seng*, at [145].

the advantage of one party but have not been sufficiently brought to the attention of the other party. In all these cases, the moulding force was and is the notion of good faith and fairness.

The other case which has influenced Leggatt J in his reference to the underlying norm of good faith in English law was Lord Bingham's discussion on the subject in the *Interfoto*<sup>23</sup> case. The facts of the case were straightforward. In a contract of hiring some photographic transparencies, severe terms of penalty for late return of the transparencies were imposed in the delivery note of the transparencies. They were not drawn to the attention of the hirer. There are precedents on such an issue which suggest a rule that such terms have to be clear and are brought to the attention of the affected party. But Lord Bingham proceeded to elicit a rational basis based on the norm of good fair and fair dealing:

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 act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as 'playing fair', 'coming clean' or 'putting one's cards face upwards on the table'. It is in essence a principle of fair and open dealing. In such a forum it might, I think, be held on the facts of this case that the plaintiffs were under a duty in all fairness to draw the defendants' attention specifically to the high price payable if the transparencies were not returned in time and, when the 14 days had expired, to point out to the defendants the high cost of continued failure to return them.

More importantly, Lord Bingham went on to say the 'piecemeal solution' of the English courts approach based upon consideration of the nature of the contract, the character of the parties and the whole circumstances whether it would be fair to hold a party to the terms of contract would 'yield a result not very different from the civil law principle of good faith.'<sup>24</sup> It is point which prompted Leggatt J to suggest that the reservation of the English position on this issue in comparison to other legal systems may be attributed to difference of opinion due to different cultural norms.<sup>25</sup>

The difference in legal cultural norms provides a good reason of the difference in approach to the notion of good faith. It does not mean that the English common law system has no interest in good faith as an incident of fairness. This link between the cultural norms of the nation and the law is the main premise of Gunther Teubner's analysis of the possible effects of good faith on the English common law system. He describes the good faith principle is one of the 'unique expression (s)' of continental legal culture. The specific way in which the continental lawyers deal with such a general clause of good faith is 'abstract, open-ended, principle – oriented, but at the same time strongly systematised and dogmatised.' This is not so favoured with the 'more rule-oriented, technical, concrete, but loosely systematised

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<sup>23</sup>*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* (1989) 1 QB 433.

<sup>24</sup> *interfoto*, at 5 and 9 (Lexis Nexis)

<sup>25</sup> *Yam Seng*, at [151].

British style of legal reasoning.’<sup>26</sup> A fuller discussion of Teubner’s thesis is undertaken in later part of this paper. Ewan McKendrick, on the same theme, suggests it is this difference in the legal culture that explains why good faith has not developed into a contractual principle. But it does not mean that English law is not concerned about matters of good faith and fair dealings. ‘It is the elevation of good faith and fair dealing to the status of general principle which is the real stumbling block.’ English lawyers have a deep –seated distrust of general principles. When faced with broad general principle, their instinct is to object that it is too vague, too uncertain or otherwise, unworkable.<sup>27</sup>

It is also noticeable that Leggatt J’s support for a more open accommodation of good faith has that characteristic English concern that it is not to be construed to mean a subjective standard of test. For that reason he considers there is advantage for it to be tied with the notion of fair dealing , so that the duty is characterised as good faith ‘and fair dealing’.<sup>28</sup> This will draw attention to the fact that the standard is an objective test.

### C Methodology

The issues in the case involved implied terms in fact as a methodology for good faith terms to be imported. The English courts employed this methodology for two purposes. The first purpose is to use it as a default rule to imply terms of good faith in a certain kind of transactions. They are the kind of contract which Lord Denning has classified as having a certain kind of relationship categorised as of ‘common occurrence.’<sup>29</sup> Examples of such kind of contracts are buyer and seller, landlord and tenant, employment contract, hirer and owner, and carrier of goods by land or sea. The rule in which terms are implied in this category of cases is known as implication in law and is regarded as not as stringent as the second purpose of implication.<sup>30</sup> The second purpose is to reallocate the risks on a fairer basis. The type of situation which the second purpose applies is where one party seeks to gain an advantage because of an omission in the contract and has not been bargained for.<sup>31</sup> The rule for terms to be implied for this second purpose is known as implication in fact.

The difficulty in this methodology lies in the tests to determine whether the contract in question merits such intervention from the courts. In addition, the tests differ for the two purposes. The tests for the first purpose as a default rule to fill in missing terms for certain kind of contract is unclear.<sup>32</sup>The traditional tests employed for implication in fact are formulated as ‘business efficacy’ or ‘officious bystander.’ The formulation of such tests is to emphasize the fact that it is out of necessity as opposed to reasonableness that the judicial

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<sup>26</sup> Gunther Teubner “Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences”(1998) *Modern Law Review* Vol61 at 19.

<sup>27</sup> Ewan McKendrick, above n 12, at 46.

<sup>28</sup> *Yam Seng*, at [150].

<sup>29</sup> *Shell UK Ltd v Lostock Garage Ltd* (1976) 1 WLR at 1196-1197

<sup>30</sup> Ewan McKendrick, above n 17, at 342.

<sup>31</sup> Hugh Collins, above n 3, at 372.

<sup>32</sup> McKendrick, above n 17, at 342.

exercise of implication is undertaken.<sup>33</sup> Such a distinction between reasonableness and necessity is significant when the methodology is employed for inclusion of good faith. This is particularly problematic in the approach taken by Thomas J and will be discussed later. Such a distinction becomes blurred with the reformulation of the tests by Lord Hoffman in the *A-G of Belize*<sup>34</sup> case. Lord Hoffmann's formulation of the tests is as follows:

**[20]** More recently, in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, 459, [2000] 3 All ER 961, [2000] 3 WLR 529, Lord Steyn said:

"If a term is to be implied, it could only be a term implied from the language of [the instrument] read in its commercial setting."

**[21]** It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. It will be noticed from Lord Pearson's speech that this question can be reformulated in various ways which a court may find helpful in providing an answer - the implied term must "go without saying", it must be "necessary to give business efficacy to the contract" and so on - but these are not in the Board's opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the background, would reasonably be understood to mean?

Formulated thus, it would appear that the tests for implied terms in fact is in essence one of interpretation of contract. What is overlooked is that the case is discussed in the context of the rule of necessity. Prior to the reformulated statement of the tests quoted above, Lord Hoffmann set out its context as follows:

**[16]** Before discussing in greater detail the reasoning of the Court of Appeal, the Board will make some general observations about the process of implication. The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed: see *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98, [1998] 1 BCLC 493, [1998] 1 WLR 896, 912-913. It is this objective meaning which is conventionally called the intention of the parties, or the intention of Parliament, or the intention of whatever person or body was or is deemed to have been the author of the instrument.

**[17]** The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.

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<sup>33</sup> McKendrick, at 346.

<sup>34</sup> *Attorney General of Belize and anor v Belize Telecom Ltd and anor* [2009] UKPC 10.

The distinction between necessity and reasonableness becomes confused when Leggatt J adopts the reformulated test to hold that there was a breach of the three imported terms of good faith mentioned in page seven above. His reasons for importing good faith seem to rely heavily on the notion of expectation of honesty in contractual relationship. 'That expectation is essential to commerce, which depends critically on trust.'<sup>35</sup>The other standard is one of fidelity to the parties bargain. He held these were key aspects of good faith in commercial contract.<sup>36</sup> The only restraining factor seems to be that good faith is 'sensitive to context'.<sup>37</sup>This reference to context is seized upon by the English courts in the cases after *Yam Seng* as the distinguishing feature of the methodology in the *Yam Seng* case.

However, a sub-text in the methodology is developed in Leggatt J's discussion of good faith. It relates to the categories of relational contracts. This part of the discussion is of particular relevance to the subject of good faith and is often referred to, as if it is a model for the topic. In paragraph [142] of his judgement, Leggatt J referred to 'relational contracts' which may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involves expectations of loyalty in order to give efficacy to the arrangements. Examples of such relational contracts might include joint venture agreements, franchise agreements and long terms distributorship agreements. It is not clear where the relational contract fits in the two purposes of implication. The way it is discussed the relational contract appears to fit into the first purpose of implication, namely those contracts of 'common occurrence' of Lord Denning. The test for this purpose appears to be less stringent in comparison to the test for implication in fact.<sup>38</sup> In other words, for certain categories of contract, good faith is more readily implied.

The question is: what are the ingredients of such relational contract which good faith will readily apply?

Todd Rakoff coins a term that captures those categories of relational contract which he developed from his analysis of Lord Denning's contract of 'common occurrences,' namely 'situation –sense.'<sup>39</sup> In his thesis, the common law judges have a good sense of what the situation-sense is. Because it is not about a 'monistic value system' or a conflict of eternal values, or a balancing or trade off of different values. It is about practical wisdom:<sup>40</sup>

The method of situation sense rejects all three of these responses. It recognises a multiplicity of values and points of view; it suggests that they can be put together coherently (not solely by rational thought, but rather by a combination of reason and social

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<sup>35</sup> *Yam Seng* , at [135].

<sup>36</sup> *Yam Seng* at [138] –[139].

<sup>37</sup> *Yam Seng*, at [141].

<sup>38</sup> Ewan McKendrick, above n 17, at 342.

<sup>39</sup> Todd D Rakoff "The Implied Term of Contracts: Of 'Default Rules' in Jack Beatson and Daniel Friedman, above n 12, at 216- 224.

<sup>40</sup> Todd Rakoff, at 224.

understanding); and it sees this reconciliation occurring more towards the ground-level than of the peaks. Situation-sense, as said before, is a method of practical wisdom.

In short, given sufficient time, the English courts will provide further examples of the categories of relational contract which is suitable for implication in law of good faith.

Hugh Collins, on the other hand, considers the relational contract be identifiable with the economic factors. He adopts the notion from Gunther Teubner who has linked good faith with the production regime to German capitalism.<sup>41</sup> German capitalism known as 'Rhineland capitalism' involves economic action that requires closed co-ordination in business association and informal business networks. This involves long-term cooperative relations amongst companies in the market, companies and their employees, companies and their owners and the suppliers of financial markets. The economic relationships tend to create long-term cooperation and at the same time considerable risks. They also demand 'high trust relations.' Such a production regime has been facilitated and supported by a system of private law in which the German courts utilise particularly the good faith principle to respond through law the risks and vulnerabilities of the regime.<sup>42</sup>

Likewise, Hugh Collins considers there could be a certain kind of agreement which 'seeks to achieve many features of organizations for the purpose of establishing efficient relations of productions.'<sup>43</sup> It is this economic factor which tips the relationship of the parties to the other end of the spectrum of good faith which requires an 'enhanced duties of loyalty and cooperation.' And so for Hugh Collins, it is a matter of regret that Leggatt J has based his decision on the narrow ground of requirement of honesty. A far better case could be established for good faith based on a broader ground of relational contract.<sup>44</sup>

On a personal note, my experience in a motor vehicle business in Malaysia has been that the industry has all the elements of a production regime that the principle of good faith is more relevant than the principle of freedom of contract. This is because the nature of the business demands a high level of cooperation and trust at many levels. Between 2010 and 2013, I was the General Manager of the Legal Department of Tan Chong Motor Group (Tan Chong), a multinational company in the sale and assembly of motor vehicles in Malaysia. Tan Chong not only holds the franchise of the Nissan brand cars for Malaysia, Vietnam, Myanmar, Laos and Cambodia, it also assembled motor vehicles for Renault, Mitsubishi and Volvo at the time I was working there.<sup>45</sup> The assembly and production of a motor vehicle is a highly technical enterprise which involves closed technical co-operation between the owner of the technology and the assembler and also the supplier of the parts. Similar technical co-operation is involved in the testing of the motor vehicles and their sale through

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<sup>41</sup> Gunther Teubner, above n 26, at 24-27.

<sup>42</sup> Gunther Teubner, at 25.

<sup>43</sup> Hugh Collins, above n 3, at 327.

<sup>44</sup> Hugh Collins, at 329.

<sup>45</sup> [Cn.wikipedia.org/wiki/Tan\\_Chong\\_Motor](http://Cn.wikipedia.org/wiki/Tan_Chong_Motor)

distributorship agreements. In the legal documentations negotiated and agreed for the assembly, production and sales of the motor vehicles, it is my experience that a better agreement is negotiated under the principle of good faith as opposed to the principle of freedom of contract. This is because all the different parts of the business are interconnected and could be characterised as one production regime.

Moreover, many of the major partners of the car industry are not from the common law jurisdiction. The principle of good faith provides a more comprehensible understanding and appeal to business people in the circumstance.

*D A model of honesty for good faith?*

There is also a part of Leggatt J judgement which suggests a more general application of good faith with honesty as one of the key incidents of it. The duty to act honestly is regarded as a 'paradigm example of a general norm which underlies almost all contractual relationship..' <sup>46</sup> or 'the core value' <sup>47</sup> of good faith. It is apparent Leggatt J is influenced by the proposition, which he cited from authoritative precedents, that there is a reasonable expectation of honesty in all commercial transactions. <sup>48</sup> If this is intended to be a model for good faith applicable in all contracts, the confusion in the methodology as discussed above becomes apparent. J.W Carter and Wayne Courtney do not think a model of good faith can be introduced as a universal principle in all contracts whilst foregoing a no good- faith default rule. <sup>49</sup> To do so is to suggest there is something wrong in the analysis of the law of implied terms or a lack of vigour in the application of the rules for implied terms. It is a confusion of the distinction between reasonableness and necessity in implied terms as discussed above in page eleven. However, Leggatt J has adopted the reformulated test for implied terms:

**[137]** As a matter of construction, it is hard to envisage any contract which would not reasonably be understood as requiring honesty in its performance. The same conclusion is reached if the traditional tests for the implication of a term are used. In particular the requirement that parties will behave honestly is so obvious that it goes without saying. Such a requirement is also necessary to give business efficacy to commercial transactions.

Utilising the reformulated statement on implied terms of Lord Hoffman, it would appear that a model of honesty for all commercial contract is advocated as an implication in law as opposed to implication in fact. It is apparent therefore the courts are not perturbed by such distinction in the methodology. As Ewan McKendrick observed about the tests for implied

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<sup>46</sup> *Yam Seng*, at [135].

<sup>47</sup> *Yam Seng*, at [141].

<sup>48</sup> *Yam Seng*, at [136].

<sup>49</sup> J.W. Carter and Wayne Courtney "Good Faith in Contracts: Is there an Implied Promise to Act Honestly?" *The Cambridge Law Journal* Vol 75 at 4 and 6 (LexisNexis).

terms, 'the distinction between terms implied in fact and terms implied in law is not always an easy one to draw, the cases do not seem to draw this distinction....'<sup>50</sup>

#### IV *Cases after Yam Seng*

In this section of the paper, attempts are made to answer the question as to whether the judiciary in subsequent cases will be willing to follow the various suggestions which were made by Leggatt J to give effect to a duty to act in good faith in the performance of a contract.

##### A *What do the cases say?*

Starting with the obvious, it can be said that in every case in which the *Yam Seng* case is invoked, the judges are anxious to emphasize that it did not lay down a general principle of good faith for English contract law. The cases considered are between the period 2013 and 2016. The critical factor for the judges in their consideration of the *Yam Seng* case is that good faith requires sensitivity to context. As a result much attention and analysis are given to the commercial context of the contract. Approached thus, the principles elicited for good faith are specific to the cases and are difficult to organise as a general principle for all cases.

A case which illustrates the above observation is the *Mid-Essex*<sup>51</sup> case. The parties in the case are a Trust body for the National Health Service (Trust) and a company which provided catering services to hospitals (the Company). They entered into service agreement for such catering services to be provided to two hospitals in Essex. The contract was for seven years and it was terminable by both parties subject to certain conditions. For the Trust, it was terminable if the services provided by the Company fell below a threshold number of service failure points. The service failure points were made on a periodical basis upon assessment of the Company's services.

The dispute of the parties was over the assessment of the service failure points. Each party served termination notice on the other over their dispute on the assessment made of the service failure points. For the Company, it claimed that the assessment was made arbitrarily which resulted in the deduction of the payment due. For the Trust, it claimed that the company's service failure points had reached the threshold number which justified termination of the service contract.

At issue were two points: (a) the effect of an express obligation in the contract that the parties to 'cooperate ...in good faith,' and (b) whether there was an implied term that the Trust was not to act arbitrarily, irrationally and capriciously in its assessing of the Company's performance.

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<sup>50</sup> Ewan McKendrick, above n 17, at 342.

<sup>51</sup> *Mid Essex Hospital Services NHS Trust v Company Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200



At the High Court, it was held both parties were justified in their termination notices and therefore both parties failed in their claims. At the Court of Appeal, it was held that the Trust succeeded in its counter claim against the Company.

In response to the *Yam Seng* case, Lord Jackson LJ, who gave the main judgement, held that it did not set a general doctrine of good faith in English law. The duty of good faith could only be implied as an incident of certain categories of contract.<sup>52</sup> The duty to cooperate was not an over-arching principle of the contract between the parties – ‘The obligation to co-operate in good faith is not a general one which qualifies or reinforces all of the obligations on the parties in all situations where they interact.’<sup>53</sup> Its effect was focussed on the specific purposes of the relevant provisions in the contract which contained the expression of cooperation in good faith. It was held that the content of good faith is ‘heavily conditioned by its context.’<sup>54</sup>

Lord Beatson LJ considered the various statements in *Yam Seng* relevant in his interpretation of the effect of the express obligation to co-operate in good faith.<sup>55</sup> Taking this approach, he held that where the contract was detailed as was the case in *Mid-Essex* which had provided specific provisions for particular eventualities, ‘care must be taken not to construe a general and potentially open ended obligation such as an obligation to ‘cooperate’ or ‘to act in good faith’ as covering the same ground as other more specific provision, lest it cut across those more specific provisions, and any limitation in them.’<sup>56</sup>

Quite clearly, the English judges’ predisposition to the doctrine of freedom of contract is preferred: what had been specifically set out and agreed by the parties would provide the certainty over importing other terms to the contract through a general principle of good faith. This preference for what are specifically set out against a general principle, expressed in the manner by Lord Beatson is adopted in subsequent cases having similar issues: see for instance, *TSG*<sup>57</sup> case, *Portsmouth CC*<sup>58</sup> case and *Monde Petroleum*<sup>59</sup> case.

An interesting issue from this body of cases involving the exercise of discretion is whether there is a place for the notion of good faith to be implied in fact, when there are existing rules of interpretation governing such discretion. The existing rules are that such discretion is constrained to be exercised not irrationally, improperly, capriciously or arbitrarily. The English courts have sometimes included reference to good faith in addition to the rules of construction; its value lies in the subjective content of good faith akin to honesty.<sup>60</sup> The

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<sup>52</sup> *Mid Essex*, at [105].

<sup>53</sup> *Mid-Essex*, at [107].

<sup>54</sup> *Mid-Essex*, at [109].

<sup>55</sup> *Mid-Essex*, at [150].

<sup>56</sup> *Mid-Essex*, at [154].

<sup>57</sup> *TSG Building Services plc v South Anglia Housing Ltd* [2013] EWHC 115 at [31]-[34].

<sup>58</sup> *Portsmouth City Council v Ensign Highway Ltd* [2015] EWHC 1909 at [85].

<sup>59</sup> *Monde Petroleum SA v Westernzagros Ltd* [2016] EWHC 1472 at [267].

<sup>60</sup> Richard Hoolay “Controlling Contractual Discretion” (2013) *The Cambridge Law Journal* at 7 (LexisNexis)

addition of good faith in construction of the term on discretion helps to focus on the central issue which is, the discretion should not be abused or that abuse could be caused by self-interest. The existing rules on interpretation of discretion expressed in such disjointed ways of irrationality, improper use, capriciousness or arbitrariness, risk losing sight of the bigger issue which is about honesty and acting in good faith. <sup>61</sup>It follows therefore, unless those values are at issue, the principle of good faith is unlikely to apply as an implied term in fact.

The judiciary also rejects that there is positive duty in good faith to consider the economic interest of the other party when a party is exercising discretion as to whether to terminate or extend the life of a contract. Whilst accepting that there is expressed obligation for collaboration in good faith in the commercial contracts, it does not mean that a party's own interest is subjected to the obligation to consider the effect of its decision on the business interests of the other party. This point is made by the Judge in the *Hamsard v Boots* <sup>62</sup>case. The parties entered into a supply contract for children's wear. The supplier of the children's wear was a company (Hamsard) and the buyer was a retail chain company (Boots). In one particular year, Boots cancelled the supply upon given reasonable notice. And it was so held by the Judge that reasonable notice of termination was given. The decision on this point should dispose of the matter. However, Hamsard argued that there was an implied term of good faith in the joint venture agreement. It argued that good faith required Boots to consider the business consequence of termination of the joint venture. That business consideration included the economic consequence it might have on Hamsard. To such a submission, Norris J made the following points in his judgement:

- That the *Yam Seng* case did not postulate a general obligation of good faith.
- He accepts if good faith is implied it means not to do anything to frustrate the purpose of the contract.
- But that does not mean 'there is to be routinely implied some positive obligation upon a contracting party to subordinate its own commercial interests to those of the other contracting party.'<sup>63</sup>
- That in general the implied term of good faith suggests an implied duty to deal with each other on an 'open and collaborative' basis. There is no obligation to maximise profits.<sup>64</sup>

Another case, similar in purpose as *Hamsard v Boots*, to give a more co-operative meaning to the contract is the *National Private Air*<sup>65</sup> case. The case involved the sublease of two aircrafts owned by a Saudi Arabian company (NAS) to a British company and a Ukrainian company. Disputes arose between the parties of the rental and expenses owing by the

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<sup>61</sup> Richard Hoolay, at 7 (LexisNexis)

<sup>62</sup> *Hamsard 3147 Ltd and anor v Boots UK Ltd* [2013] EWHC

<sup>63</sup> *Hamsard v Boots*, at [86].

<sup>64</sup> *Hamsard v Boots*, at [87].

<sup>65</sup> *National Private Air Transport Services Company ( National Air Services ) Ltd v Creditrade Llp and anor* [2016] EWHC 2144.

British and Ukrainian companies of the aircrafts to NAS. The technical arrangements for the redelivery of the aircrafts are complex and will not be need to be discussed in detail. There were further agreements by the parties with regard to their redelivery because of remedy work to be done. As a result, the aircrafts were redelivered late. It was held, from the interpretation of the sublease, the defence was partially correct that rental from November 2012 to January 2013 was waived but the rental from February to April 2013 was payable. However, the defence raised the issue of good faith. The point they made for good faith is premised on expert evidence that termination of lease of aircraft is normally done with further negotiations and communication on a line of outstanding matters which include items of 'wear and tear.' The return of the aircrafts is a cooperative process and it is the normal industry practice. Therefore the terms needed for this part of the parties agreement should not be bound by literal compliance of the terms of the agreements.<sup>66</sup>

Blair J's response to the said legal submissions is:<sup>67</sup>

**[135]** I do not accept that NAS is correct to doubt the authority of the decision in *Yam Seng*. Although its treatment in the cases has varied, this has reflected the very different factual circumstances in which it has been raised. So far as appellate authority is concerned, it has recently been cited with approval by the Court of Appeal in *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396 at [67], and by the Singapore Court of Appeal in *The One Suites Pte Ltd v Pacific Motor Credit (Pte) Ltd* [2015] SGCA 21 at [44].

**[136]** I do however accept NAS's submission that an aircraft lease or sublease is not a "relational" contract in the sense that phrase is used in *Yam Seng*. These are conventional contracts in which the parties' relationship is "legislated for in the express terms of the contract" (see *Yam Seng* at [143]). There may be an expectation of cooperation upon redelivery, but this does not give rise to an implied term redefining the redelivery obligation. The defendants' case rests on an assertion that in the ordinary course, there will be "give and take" on the redelivery of an aircraft. That is so, but the lessor is entitled to require that the aircraft is redelivered in accordance with the contractual terms, and there is little room for a distinction between "compliance" and "literal compliance" in this context.

The English courts have also found that in financial contracts there can only be limited application of the duty of good faith. An example of such a financial transaction is the *Greenclose*<sup>68</sup> case. In this case, the borrower in a loan contract entered into an interest rate hedging transaction with the bank. It was a financial instrument which speculated on the movement of interest rate. The financial instrument was a prerequisite to the loan contract. The bank required this hedging arrangement to be entered by the borrower. At the end of the term of the hedging contract the bank was given the sole discretion to extend the financial instrument to a further two years period provided that notice had been given to the borrower according to the terms of the contract. It was held by the Judge in the case

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<sup>66</sup> *National Private Air*, at [132]-[133].

<sup>67</sup> *National Private Air*, at [135]-[136].

<sup>68</sup> *Greenclose Ltd v National Westminster Bank* [2014] EWHC 1156; also *Myers and anor v Kestrel Acquisition Ltd and others* [2015] EWHC 916(Ch).

that notice was not properly given and that should settle the dispute in favour of the borrower.

However, issues were raised relating to the implied duty of good faith, namely, that under the bank's discretion to extend the hedging contract, it was obliged to consider:

- Whether it was reasonably necessary for the protection the interest of the borrower.
- Whether it would materially increase the risk of the borrower.
- Whether it constituted fair dealing.

To those issues, Andrew J held that 'such term is unlikely to arise by way of necessary implication in a contract between two sophisticated commercial parties negotiating at arms' length.'<sup>69</sup>His reasoning is cited with approval and adopted in a later case of *Myers*.<sup>70</sup>The Judge in *Myers* went on to hold that it would require 'exceptional circumstances' in such complex commercial contracts for implication of the duty of good faith.<sup>71</sup>

The reason why financial contracts are not suitable to the notion of good faith is that they are complex transactions and in most cases, involve entering into a kind of financial arrangement known as derivatives. Interest rate hedging is a form of derivative transaction which is held by the English courts to be speculative; see the *Hazell*<sup>72</sup> case. The courts working principle on matters relating to financial instruments transacted by the banks, is that it is to be approached on the basis of caveat emptor.<sup>73</sup>Moreover, the standard terms of such financial contracts adopt the master agreement of the International Swap Derivatives Association (ISDA) which is drafted on the principle of caveat emptor. The parties in the *Greenclose* case used the ISDA Master Agreement. This makes the notion of parties needing to be alert to the dangers of such a contract at odds with the notion of parties requiring cooperation in good faith.

The most positive judicial statement of a "model" for the duty of good faith is when reference is made by the judges to relational contract as mentioned in the *Yam Seng* case. The features of such contracts are as described in the *Yam Seng* case: long term contract, contract which requires enhanced communication and cooperation. Inevitably, in most of the cases, the party that invokes good faith will characterise its contract as fitting that description. A good example of such a case is found in the *Globe Motors*<sup>74</sup>case. The case is about interpretation of an exclusive supply contract of a very technical product in the motor vehicle industry. The issues raised in the case related to the question as to whether there was a breach of the supply agreement when the buyer of the product decided to appoint

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<sup>69</sup> *Greenclose* , at [150].

<sup>70</sup> *Myers and anor v Kestrel Acquisitions Ltd and others* [2016] 1 BCLC 719 at [40].

<sup>71</sup> *Myers*, at [62].

<sup>72</sup> See *Hazell v Hammersmith and Fulham London Borough Council* [1992] 1 AC 1.

<sup>73</sup> See *Cassa di Rasparmio della Repubblica San Marino v Barclays Bank* [2011] EWHC 484

<sup>74</sup> *Globe Motors Inc and others v TRW Lucas Vanity Electric Steering Ltd and anor* [2016] EWCA Civ 396.

another supplier for a later development of the product. At the Court of Appeal, Lord Beatson LJ, speaking obiter on this issue of implication said:<sup>75</sup>

One manifestation of the flexible approach referred to by McKendrick and Lord Steyn is that, in certain categories of long-term contract, the court may be more willing to imply a duty to co-operate or, in the language used by Leggatt in *Yam Seng PTE v International Trade Corp Ltd* [2013] EWHC 111 (QB) at [131], [142] and [145], a duty of good faith. Leggatt J had in mind contracts between those whose relationship is characterised as a fiduciary one and those involving a longer-term relationship between parties who make a substantial commitment. The contracts in question involved a high degree of communication, co-operation and predictable performance based on mutual trust and confidence and 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". He gave as examples franchise agreements and long-term distribution agreements. Even in the case of such agreements, however, the position will depend on the terms of the particular contract.

An illustration of the certain categories of long term contract is the *D&G Cars*<sup>76</sup> case. The Judge in this case described the relational contract as 'par excellence' for the implication of good faith. The contractual arrangement of the parties involved the recovery and disposal of the motor vehicles which the police outsourced to D&G Cars. The Police at some point in the contract terminated their contract with D&G Cars and also terminated its participation from future tendering process. D&G Cars claimed against the Police for breach of contract and alleged that they had acted in bad faith.

Dove J listed the following reasons why incidents of honesty and integrity were essential incidents of good faith in this case:<sup>77</sup>

- The arrangement created a relatively lengthy period of relationship which involved large number of individual transactions in the management of the motor vehicles under the auspices of the contract.
- The substance of the contract involved dealing with motor vehicles recovered from the members of the public.
- Some of the vehicles were expected to be returned to their owners.
- Some of the vehicles were kept as evidence in criminal proceedings.

The distinguishing characteristic of the contract is the element of trust and integrity required in the performance of a public duty in the arrangement between the parties. It is this element which renders the contractual relationship as one of par excellence for good faith terms to be implied in fact.

On the other hand, in a different situation the element of trust and integrity in the performance of a public duty might discount the importation of good faith in the contract.

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<sup>75</sup> *Globe Motors*, at [67].

<sup>76</sup> *D&G Cars v Essex Police* [2015] EWHC 226(QB) at [176].

<sup>77</sup> *D&G Motors*, at [176].

The *Camurat*<sup>78</sup> case is a case in point. The contract signed between the parties was a compromise agreement due to the dismissal of the claimant (Camurat) from a teaching position by the Thurrock Borough Council (the Council). There were some concerns about the behaviour of Camurat towards the students. Camurat requested for a certificate of past criminal records from the police. The police discussed Camurat's case with the Council. The Council disclosed a chronology of events that had led to the dismissal. Camurat sued the Council for negligent misrepresentation on the ground that it failed to exercise reasonable care and skill when communicating to the police.<sup>79</sup> The *Yam Seng* case was cited in aid to say it was an implied term in the compromise agreement that a duty of reasonable care and skill was required when communicating to a third party. The purported reason was the compromise agreement was a relational agreement. The Judge held that Camurat had not proven that the agreement was a relational agreement. It was an agreement that was brought about in the context of an adversarial position.<sup>80</sup> However, a public policy point was also made and accepted by the Judge, namely, even if there was such an implied term or even an expressed term to that effect, it was void being contrary to public policy and ultra vires the Council's power to enter into such a term. There was a public duty owed to the police in their inquiry on the safety to children at school to disclose the information contained in the compromise agreement.<sup>81</sup>

## *B A summary of the cases*

It is proposed that a summary of the cases after *Yam Seng* be considered under two main headings: (a) directions of development of good faith and (b) relational contracts.

### *1 Directions of development of good faith*

Quite clearly the intended purpose of Leggatt J for a more general application of good faith in the performance of commercial contract is not followed in the cases after *Yam Seng*. In general, the methodology employed for this purpose, namely by implication in fact, does not lend itself to such a development. The methodology coupled with the English legal culture of precedents does not develop in this instance, a model for a general application of good faith that could apply in all commercial cases. This is apparent in the criticism considered above on a possible model of honesty as it contradicts the methodology employed.

The situation has been foreseen by Teubner in his seminal paper written in 1998,<sup>82</sup> well before the *Yam Seng* case. From his analysis of the connection between the law and the

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<sup>78</sup> *Camurat v Thurrock Borough Council* [2014] EWHC 2482.

<sup>79</sup> *Camurat*, at [59].

<sup>80</sup> *Camurat*, at [71]-[72].

<sup>81</sup> *Camurat*, at [65].

<sup>82</sup> Gunther Teubner, above n 26.

unique legal culture which he described as ‘distinctive British mode of episode linkages,’<sup>83</sup> he sees the judicial response might take the following directions:<sup>84</sup>

- They would not transplant the continental concept of good faith. ‘But it will “irritate” British legal culture considerably.’
- ‘The predictable result will be a judicial doctrine of good faith that is much more “situational” in character.’ As a consequence the English law on good faith will develop on an ‘analogical basis,’ with new rules coming out of a close analysis of the factual situations involved. Principles that are elicited ‘will not be translated into strictly conceptualised and systematised doctrines, but rather appear as loosely organised ad hoc arguments that do not deny their political-ethical origin.’

In general, the cases after the *Yam Seng* case support the above conclusions. However, there are some clear directions from the cases which show where good faith will progress.

Firstly, in cases where good faith is an issue of dispute, then it will be implied as a term of performance of the contract. The *Yam Seng* case itself is a prime example of such a case. It is for this reason that Legatt J has grounded his judgement on honesty as opposed to relational contract. Similarly, it is the issue of good faith in performance of the contract in the *D & G Cars* case which has invited the judge to hold that it is case eminently suitable for the importation of the principle of good faith.

Secondly, in cases where the issue involved the way discretionary powers are exercised under the contract, the courts prefer certainty to general principle. The rationale of the courts is as expressed by Lord Beatson LJ in the *Mid-Essex* case, namely that a meaning to be derived from a general principle should not be permitted to cut across what has been agreed and set out in the agreement by the parties.

Thirdly, in cases which involved financial transactions, good faith would have limited application because they are complex transactions between sophisticated investors. It is suggested the subject is not closed. The English courts are known for their practical wisdom and pragmatism in commercial matters. The reality of the financial market is that there are excesses in the trading, that the risk is unknown and there is phenomenal loss in the transaction. The question is whether this is best managed by the principle of cooperation as opposed to caveat emptor. The subject will be discussed in detail in the next section of the paper.

Fourthly, there are cases, like the *National Private Air* case which the courts with a more matured consideration of a relational contract might decide the facts of the case constitute a relational contract. The case is after all a lease agreement and it is therefore the kind of contract that falls within the transaction of “common occurrence” which suggests that good

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<sup>83</sup> Gunther Teubner, at 21.

<sup>84</sup> Gunter Teubner, at 20- 21.

faith can be implied in law as opposed to implication in fact. It could be the judge in the case was influenced by the stricter approach of the law of implication in fact because of the recent decision of the Supreme Court in the *Marks and Spence*<sup>85</sup> case (which is discussed later in the paper).

The ultimate question in the cases is whether the approach of the English judiciary in the cases has produced a fair outcome as the civilian system. Lord Bingham had thought that it would in his espousal for good faith in the *Interfoto* case. The conclusion from consideration of the cases suggests that they have. Where in those cases good faith is invoked to facilitate a more cooperative approach of the parties to the issue, the courts consider the solution should be found on what the parties have agreed and their commercial purpose. This is the virtue of the doctrine of freedom of contract. Otherwise it would suggest unnecessary intrusion by the courts. Or the courts are improving on the parties' contracts. Where it is the nature of the contract that the parties have to act with honesty and integrity, and those matters are an issue of dispute as in the *Yam Seng* case and *D & G Cars* case, the courts have readily imported good faith as a solution. Similarly they have expressed their willingness to import good faith where the contract is classified as a relational contract.

Furthermore, the English judiciary are alert to the fact that in litigation or dispute a general principle of good faith may produce uncertain outcome. For instance, in the United States, where the principle of good faith is incorporated in its contract law under the Uniform Commercial Code, American Institute's Restatement (2d) of Contracts, and the United Nations Convention on Contracts for International Sales of Goods, the American courts are wary of an independent cause of action based on good faith or the notion good faith should prevail over expressed terms for termination of contract.<sup>86</sup> There appears to be a nagging concern that a general principle application of good faith, may lead to uncertain results in litigation.

## 2 *Relational contracts*

The most positive statement on good faith in the aftermath of the *Yam Seng* case relates to the concept of relational contracts. This is clear from the judgement of Lord Beatson LJ referred to on page 21 of this paper. Whilst the characteristics of such relational contracts have been identified in the *Yam Seng* case and many of the cases after it manifest those features, except for the *D & G Cars* case, there are no cases decided on that basis. *D & G Cars* case provides little guidance what the elements are which will constitute a suitable relational contract that will invite the court to readily import a term of good faith. It was the issue of dispute about bad faith that has prompted the court's decision to invoke the principle of good faith.

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<sup>85</sup> *Marks and Spencer plc v BNP Paribas Securities Services Trust Company ( Jersey) Ltd and anor* [2015] UKSC 72.

<sup>86</sup> E Allen Farnsworth "Good Faith in Contract Performance" in Jack Beatson and Daniel Friedman, above n 12, at 163, 166, 169.



As mentioned in the discussion on pages 13 to 14 above, the question is what are the distinguishing elements of the relational contract for the courts? The cases after *Yam Seng* have not discussed this in detail. A very attractive idea which has been considered by academic writers is the German economic production regime, where good faith is applied as facilitative force for the benefit of the economy. Teubner has been the main exponent of this notion and he characterised that in such a production regime, 'economic action is closely coordinated by business associations and by informal business networks.' Such long-term cooperation relations exist at all levels of the production: between companies in the market, between companies and employees, between companies and their owners and suppliers of the financial market. Such a culture is known as 'business-coordinated market economy'. Such a production regime has been facilitated and supported by a system of private law in which the courts employed good faith principle to bind the relationship.<sup>87</sup> A version of this is suggested by Hugh Collins of a contractual relationship based on informal networking.

But Teubner sees the role of good faith in a liberal market like Britain is limited, because organised business is weak, and plays a limited role in coordinating institutional framework. In such a situation, the role of the government agencies and the courts is rule-setting and in the case of the latter it takes on a 'low- discretionary form.' The role of good faith in the English system would be used to 'outlaw certain excesses of economic action.'<sup>88</sup> He sees the constraining role of good faith being employed in two ways:<sup>89</sup>

- 'A constraint on strong hierarchies of private government'. This means good faith principle might be developed to limit any form of private government in contractual relationship and provide for a form of constitutional 'rights' in contract.
- 'A constraint on certain expansionist tendencies of competitive processes.' In this situation, the English courts might use good faith to invalidate the standardised form of contracts imposed on the market.

Whilst that would be the obvious logical conclusion about the role of the courts in a free market situation, the reality is that it may not be necessarily so. The reasons for this are twofold: firstly, the English courts are quite pragmatic to the commercial reality of the transaction. Secondly, the economic production under the trend of globalisation is more interconnected as one production unit.

A good illustration is that there is no such restraining hand of the judiciary to private government in the financial market. For instance, in the transactions of financial derivatives, they normally adopt the terms of the master agreement of ISDA. ISDA is a private body which attempts to govern the derivatives market and it is a role which is accepted by financial authorities universally, including Britain. The English courts' position toward the

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<sup>87</sup> Gunter Teubner, at 25.

<sup>88</sup> Gunther Teubner, at 28.

<sup>89</sup> Gunther Teubner, at 28-30.

ISDA Master Agreement has been firmly established in the *Lomas*<sup>90</sup> case, a decision of the Supreme Court. The case was referred to in *Greenclose*. The *Lomas* case was a direct challenge to the validity of the ISDA Master agreement. ISDA was allowed to participate in the proceeding as an intervening party. The transactions involved derivatives contract in the form of interest rate swaps and forward freight agreements on ISDA form of master agreement. One of the issues raised in the solvency proceeding was the validity of the term in the ISDA Master Agreement 1992 which provided for the obligation of payment to continue regardless of the event of a bankruptcy default. It raised the question as to whether such a provision was contrary to the anti-deprivation rule in solvency law. The terms of the ISDA Master Agreement was upheld to be effective.

For the above reasons, the courts' approach on the question of good faith to financial is not closed. There could be a role for good faith as providing a solution to the huge loss arising from abnormal economic changes and also, providing a binding role in the financial market for mutual cooperation and trust in the financial market. The financial market is a regulated market. The current regulation in Britain is the Financial Market Act 2012 (FSA). Under the FSA, three main institutions coordinate to regulate the market:<sup>91</sup> the Bank of England which has the function to protect and enhance stability in the financial system, the Prudential Regulatory Authority which sees to the day to day supervision of financial institutions, and the Financial Conduct Authority, which oversees how firms conduct their business with an emphasis on promoting confidence and transparency. In addition, the English courts have established a specialist court<sup>92</sup> to hear financial cases. In short, the financial market in Britain has all the hallmarks of a production regime of Germany as described by Teubner.

The major concerns have been the excesses in trading in certain financial instruments and the phenomenal losses which had led to the financial crisis in 2008. The legal principles of the courts and the regulatory bodies in the market have been that of freedom of contract and with it the doctrine of caveat emptor albeit subject to regulatory measures. That has not constrained the excesses and diminished the enormous financial loss in trading of those financial instruments. The courts' view of the role of good faith in the financial instruments as described in the cases of *Greenclose* and *Myers* was that it could be of limited application because such transactions are complex and the parties must be held to the terms of the contract. The parties are also considered to be sophisticated investors and that they should know better. Such an approach ignores some important issues in the financial market: the need for clarity in the transactions and the unforeseen risks. These are the factors which cause huge economic loss to the parties. Good faith as opposed to caveat emptor could be a better working principle to address those issues.

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<sup>90</sup> *Lomas and others (joint administrators of Lehman Brothers International (Europe)) v JFB Firth Rixson Inc and others (International Swaps and Derivatives Association Inc intervening) and other appeals* [2013] 1 BCLC 7; [2012] EWCA Civ 419.

<sup>91</sup> Michael Davies and Richard Thornton "The New UK Regulatory Framework. Impact and Implications on Financial Institutions." (2013) WIPRO Technologies.

<sup>92</sup> Financial List Claims under Civil Procedure Rules 1998, Part 63A, Practice Direction 63AA.

An inclusion of a principle of good faith would address such a problem. An example of such a rule of good faith is found in Article 437(1) of the Portuguese Civil Code:

437 Abnormal change in circumstances

1. If the circumstances on which the parties based their decision to enter into a contract have undergone an abnormal change, the injured party is entitled to termination of the contract or to modify it in accordance with principles of equity if fulfilment of that party's obligations under the contract would be a serious breach of the principles of good faith and if the abnormal changes do not form part of the risks covered by the contract.

The English court had to consider this provision in the case of *Banco Santander v De Ferro*.<sup>93</sup> The parties of the case were a Portuguese bank and a Portuguese state owned transport company. The transport company had entered into interest rate swaps for the purpose of managing their mounting debt and funding needs. Their derivative transactions involved interest rate swap with the added feature of a risk spread, calculated to a formula which had a snow like effect where the rates fell outside the fixed range of interest rates. As a result of the financial crisis in 2008, the state owned transport companies incurred a huge loss because of the drop in interest rate. One of the issues raised in the case was whether the financial crisis constituted an abnormal change that would entitle the state owned transport companies to terminate the contract. It was held that Article 437 (1) did not apply, but had it applied, the financial crisis causing a drop in the interest rate was abnormal change in circumstances and fulfilment of the financial obligations would be a breach of the principles of good faith.<sup>94</sup> The state owned companies would be entitled to cancel most of the derivatives contracts, thus reducing its losses.

There is also another important issue currently facing the financial market and that is restoration of trust and fiduciary duty amongst the players in the market. Since the financial crisis, the most common suggestion of a remedy for the financial market is restoration of trust<sup>95</sup> between the players of the market and a new legal narrative of mutuality and cooperation in financial law.<sup>96</sup> An application of the principle of good faith in the contracts and in legislations could bring about those results.

In a word, there could be possible development in relational contract which could bring about a change in the methodology as well. The methodology may shift from implication in fact to implication in law, towards the categories of contract which are of the 'common occurrences' or 'situation-based' kind. Such a change in methodology will indeed facilitate a readier accommodation of good faith in English contract law. As Ewan McKendrick observed

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<sup>93</sup> *Banco Santander Totta S.A. v Companhia De Carris De Ferro De Lisboa S.A. and others* [2016]EWHC 465 (Comm)

<sup>94</sup> *Banco Santander* at 137

<sup>95</sup> Stephen Davis, Jon Lukomnik, David Pitt-Watson *What They Do With Your Money. How the Financial System Fails Us and How to Fix It* (Yale University Press, New Haven and London, 2016).

<sup>96</sup> Joanna Benjamin "The Narratives of Financial Law" (2010) *Oxford Journal of Legal Studies* Vol 30, No.4

in cases on implied terms, the test for implication in law is less stringent than implication in fact.

V *Thomas J approach to good faith*

A *Discussion of the cases.*

The *Yam Seng* case has not been referred to by the New Zealand courts. But good faith principle has been developed in New Zealand contract law by Thomas J in three of his cases. The three cases will be considered to determine how he included good faith in New Zealand contract law and at the end, a reason is suggested why it is not readily accepted.

The first case which Thomas J invoked the duty of good faith was the *Livingstone* case. Livingstone bought a car from Roskilly and part of the purchase included doing some repairs to the car. The car was left at Roskilly's garage. The car was stolen and Livingstone sued and claimed for the value of the car. One of the issues raised was whether a warning sign containing the phrase –“all care taken: no responsibility”- at the garage door served as an exclusion of liability.

The issue involved the legal question of interpretation of contract. Thomas J construed the wordings of the warning sign on the principle that to exclude liability in the contract, the words to that effect have to be ‘clearly intended.’ This is not a an artificial or arbitrary rule of construction but a realistic one which recognises that parties under common law are not taken to have intended to exclude their responsibility unless they are stated in ‘clear and unambiguous’ terms.<sup>97</sup>

Thomas J then went further and referred to a more general principle of good faith as propounded by Lord Bingham in the *Interfoto* case where the issue was about onerous term of contract was unilaterally imposed on another party. He would readily apply such a principle of good faith in contract law for the following reason:<sup>98</sup>

I am pleased to apply this principle in the present context subject only to adding that, for myself, I would not exclude from our common law the concept that, in general, the parties to a contract must act in good faith in making and carrying out the contract. Lord Mansfield may be long since dead and buried but his spirit is not entirely extinguished. To that great law Lord, good faith was "the governing principle . . . applicable to all contracts and dealings" (see *Carter v Boehm* (1766) 3 Burr 1905). His tradition was never swamped in the United States as it was in England by the formalism of the 19th and 20th centuries. But the principle has survived, I suggest, as the latent premise of much of our law relating to the formation and performance of contracts. The rule which invalidates a penalty provision; the law providing for relief against forfeiture; rules providing for the importation of implied terms and the severance of ineffective terms to give a contract business efficacy; and rules of construction such as the *contra proferentem* rule and the like are but a few examples. *Devonport Borough Council v Robbins* [1979] 1 NZLR 1 illustrates the Court's readiness in

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<sup>97</sup> *Livingston* , above n 9, at 234.

<sup>98</sup> *Livingston* at 238.

this country to impose in certain contracts an obligation to co-operate in the performance of a contract (see especially the dicta of Richardson J at pp 28-30).

The key to Thomas J's reasoning lies in the proposition that good faith is a 'latent premise' in much of the New Zealand or English law on contract. This is repeated in the next case.

The second case was the *Bobux* case which went to the Court of Appeal. The parties entered into a distributorship agreement of baby's leather booties. The manufacturer and supplier of the booties was Bobux who was also the proprietor of the brand name "Bobux" and the distributor was Raynor. The latter wanted to extend the product to children who were over two years old but Bobux was not agreeable. Then Raynor wanted to produce this over two years old version of the product itself but Bobux could not agree to this because it might infringe its brand name. The distributorship agreement did not provide for Bobux to terminate the agreement although termination was allowed for Raynor should its order for the product fall below certain threshold number. Bobux sought a declaration that it could terminate the agreement upon reasonable notice. It failed at the High Court and the case went on appeal to the Court of Appeal. The majority at the Court of Appeal upheld the decision of the High Court.

Thomas J delivering the minority decision allowed the appeal on the ground that he was prepared to import a term that allowed Bobux to terminate the agreement; that this was the commercially realistic expectation of the parties:<sup>99</sup>

For myself, I would be prepared to import a term giving Bobux the right to terminate the contract on reasonable notice simply to avoid giving effect to a contract which is otherwise commercially unrealistic.

He would do so, by means of interpreting the nature of the contract to that effect.<sup>100</sup> The grounds for interpretation thus, are basically two-fold:

- Firstly, there has been recognition by the common law Judges that the parties in a contract expect an 'effective and fair framework of contract.'<sup>101</sup>
- Secondly, there is 'latent premise' in the formation and performance of contract to produce fair and just results.<sup>102</sup>

Thomas J went on to add that the notion of good faith in contract has been given a boost in the United States, in the Uniform Commercial Code and Restatement of Contracts, Second and also in international trade law, in UNIDROIT Principles of International Commercial Contract and art 7(1) of the Conventions on Contracts for the International Sale of Goods.<sup>103</sup> The reference to the international sources is an obiter part of his decision. The

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<sup>99</sup> *Bobux*, above n 10, at [5]

<sup>100</sup> *Bobux*, at [6].

<sup>101</sup> *Bobux*, at [35].

<sup>102</sup> *Bobux*, at [40].

<sup>103</sup> *Bobux*, at [35], [39]-[40].

ratio decidendi of his decision is that his interpretation of the contract is in accordance to the common law expectation of fairness.

Blanchard and Keith JJ's response to Thomas J exposition on good faith is brief and reserved. It is difficult to determine from the short paragraph of their joint decision why they do not agree with the two grounds which Thomas J has based his interpretation of contract. Most probably they want to restrict themselves to the nature of the claim which was for a declaration. Perhaps they may respond more openly if the remedy sought in the case is for mistake or rectification.<sup>104</sup>

The third case was the *Wholesale Distribution* case. The issue raised in the case was also one of interpretation of the terms of a contract. The parties entered into an assignment of a sublease. The sublease was structured in two parts: the first part was for a period from 10 July 1991 to 30 October 2002 and the second part was for the period 30 October 2002 to 31 October 2010. The purpose for the structure was to avoid the appearance that it was an assignment of the head lease. The sublease was assignment to another party and the assignment of the sublease likewise reflected the two periods, namely, from the date of the assignment on 3 April 1997 to 30 October 2002 with the option to renew from that late date of expiry to 31 October 2010. The issue was with regard to the payment of the rental as to whether it was for the first part of the period of the sublease or the whole of the two periods of the sublease. The issue called for interpretation of the phrase in the assignment of the sublease which said: 'remainder of the term of the lease sublease to pay the rent.' In particular, at issue was: what does 'remainder of the term' mean?

The case was appealed up to the Supreme Court of New Zealand and the judges were unanimous in taking into consideration of the commercial context and conduct of the parties in their construction of the contract. They concluded that 'the remainder of the term' meant the whole period of the sublease consisting of the two periods.

But Thomas J, after reaching the same conclusion as other members of the bench, went on to discuss the principle of good faith. The premise of his proposition of good faith, as in his previous discussions, is the reasonable expectation of commercial parties to honest and fair dealing. This has been the underlying premise in English contract law:

[148]It is now ten years since Lord Steyn obtained universal support for his basic proposition that the law of contract should protect the reasonable expectations of honest men and women. The law of contract will not deliver on this exhortation if it is prepared to permit parties to renounce their solemn bargains. A law which accepts this response cannot meet the reasonable expectations of honest men and women. Honest men and women expect to perform the promises they have made and expect the other contracting party to do the same. The law cannot, and should not, appear indifferent to these reasonable expectations.

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<sup>104</sup> *Bobux*, at [80]

[149] Notwithstanding its widespread acceptance in most common law and civil jurisdictions in the world and growing judicial support, the courts have not yet incorporated the doctrine of good faith into our law. There is a widespread belief that existing doctrines or judicial devices already encompass a requirement of good faith. It would, it is said, add nothing to the existing tools and principles of the common law, such as estoppel and implied terms. This case serves to demonstrate that this belief is misplaced. It is clearly arguable that WDL have not acted, and are not acting, in good faith. Indeed, if such a doctrine existed in the law, it is doubtful whether the courts would have been troubled by the company's attempt to achieve an interpretation to its intention. I would firmly hold it to that intention.

None of the members of the panel in the Supreme Court chose to take up the issue of good faith for discussion.

### *B A commentary*

The most striking feature in the Thomas J's discussion on good faith in the three cases is that it is invoked from interpretation of certain terms of the contract. In all the three cases the issue before the court was not about implied terms as was the case in the *Yam Seng* case and the cases considered above. For this reason, Thomas J's discussion on the subject is unnecessary and his decision on this issue obiter, which probably explains why the other members in the bench would not follow him in the discussion of the subject at the appellate courts.

That aside, the question is whether how appropriate is the methodology employed by Thomas J in treating interpretation and implying of terms as one single process. The issue was discussed in the *Marks and Spencer* case. The issue in the case was about importing a term in a complex tenancy in the tenant's claim for a refund of the rent. The tenant succeeded in its claim in the High Court but lost in the appeal to the Court of Appeal. The tenant then appealed to the Supreme Court. The Supreme Court took the opportunity to discuss the issue of implied terms with special reference to the reformulated test of Lord Hoffmann in the *A-G of Belize* case. Lord Neuberger, P stated the following views on implied terms:<sup>105</sup>

- There is no dilution in the requirement which have to be satisfied before a term can be implied.
- Whilst it is accepted that implying a term is part of the interpretation of contract as suggested in the *A-G of Belize* case as both involve determining the scope and meaning of the contract, construing the words used and implying additional words are different processes governed by different rules.
- A summary of the difference in the two processes are as stated by Lord Bingham:<sup>106</sup>

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<sup>105</sup> *Marks and Spencer*, at [24]- [29].

<sup>106</sup> *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472, CA at 481

The courts' usual role in contractual interpretation is, by resolving ambiguities or reconciling apparent inconsistencies, to attribute the true meaning to the language in which the parties themselves have expressed their contract. The implication of contract terms involves a different and altogether more ambitious undertaking: the interpolation of terms to deal with matters for which, *ex hypothesi*, the parties themselves have made no provision. It is because the implication of terms is so potentially intrusive that the law imposes strict constraints on the exercise of this extraordinary power.

Not to make such a distinction of the two processes is to be faced with the accusation as apprehended by Lord Bingham that the action of the courts is 'potentially intrusive.' There is danger that the courts are improving on the contracts which they need to safeguard against. Lord Mansfield's view on commercial contract, which was cited frequently by Thomas J in his decisions, was particularly concerned that the courts should not impose their own rules on commercial parties.<sup>107</sup> Lord Mansfield attitude towards the law merchants in their business transactions was that "the daily negotiations and property of merchants ought not to depend on subtleties and niceties, but upon rules easily learned and easily retained because they are dictates of common sense drawn from the truth of the case."<sup>108</sup> What this suggests is a mixed bag of rules which accord well with the law merchants' way of doing business: good faith in commercial dealings, for the sake of certainty adhere to previous decisions, follow established customs or usage, give liberal interpretation to commercial contracts, and collaborate with merchants.<sup>109</sup>

A further concern about Thomas J's approach is its equation of good faith and reasonableness. It is treated as if it is one concept. It is fact two concepts. Reasonableness is objective norm of behaviour whereas good faith refers to a subjective state of mind characterised by honesty. Whilst acting in good faith would be an important aspect of acting reasonably, it does not follow that it will necessarily satisfy the standard of reasonableness for the purpose of the particular contract. One could act in good faith and yet does not satisfy the higher standard of reasonableness expected in the contract. The difference in the two concepts is made by Cooke J in the case of *SNCB Holdings*<sup>110</sup> case. USB exercised its contractual rights to replace one of the securities held with another form, against the interests of SNCB who argued that it was the reasonable expectation that its interest be taken into account. Cooke J held that as it was not an issue about dishonesty or lack of good faith on the part of USB, then good faith could not be imported because good faith did not mean anything more than those qualities.<sup>111</sup> The Australian courts appear to have taken such a fusion of concept of reasonableness and good faith and Richard Hoolay thinks this is regrettable. The consequence of such an approach is that the courts' view on good faith

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<sup>107</sup> Edmund Heward *Lord Mansfield*( Barry Rose (Publishers) Ltd, Chichester and London, 1979) at 101.

<sup>108</sup> *Hamilton v Mendes* (1761) 2 Burr at 1214, cited by Edmund Heward at 101.

<sup>109</sup> Edmund Heward, at 101.

<sup>110</sup> *SNCB Holdings v USB AG* [2012] EWHC 2044 at [65].

<sup>111</sup> *SNCB Holdings*, at [72] per Cooke J.



based on what is reasonable may come to substitute the subjective element of good faith as agreed by the parties.<sup>112</sup> That is a threat to the English concept of freedom of contract.

## VI Conclusions

The *Yam Seng* case is a landmark case in introducing the notion of good faith in performance of contract in English contract law. By providing a rationale for good faith which is consonant with the English sense of fair dealings implicit in all performance of contract, it has stimulated invocation of good faith in the cases after it as a solution to some of the issues in the contract. The methodology for its inclusion is that of implication in fact. That means good faith is required to be sensitive to context. That entails meticulous attention is given by the courts in the details and commercial background of the contract. This is the most distinguishing feature of the English courts in their approach. In doing so, certain principles are developed from the cases. Whilst those principles are facts specific to the case, they have been applied analogously in subsequent cases. Certain general principles could be identified. Issues relating to the way discretions are exercised which affect the other party's interests are not construed to import good faith to extend their meaning or purpose. They are to be given a meaning as so defined by the expressed terms of the contract. That is so, even if there is expressed intention of the parties to cooperate in good faith. Principle of good faith is not imported to extend its application to the whole contract. Contracts involving financial matters are considered inappropriate for good faith to apply as they are commercial contracts between sophisticated investors. However, the courts generally accept a more ready application of good faith in certain categories of relational contract. It is not clear what the ingredients for such a relational contract are where good faith can readily apply, as an implication in law as opposed to implication in fact. Teubner has provided a useful model based on the German experience of a production regime. Good faith could serve as a facilitative and binding factor in the production regime. An analogy to a production regime could be drawn from industries where all the players are interconnected to each other and required to work closely together. The financial market could be one of the industries and so is the motor vehicle industry relating to the assembly of cars. However, at the end of it, the way how this is determined is one of practical wisdom as suggested by Todd Rakoff. It is a matter of time before the English judges will develop clearer guidelines as to what will constitute a "situational-sense" for a relational contract that good faith could readily apply by implication in law.

*Word count:*

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<sup>112</sup> Richard Hoolay, above n 60 at 6 (Lexis Nexis).

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