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A Core Expectation of Honesty and Swimming Against the Tide:

Yam Seng Pte Ltd v International Trade Corporation Ltd [2013] EWHC 111 (QB)

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Introduction

In Scots law good faith exists as a background to contract law but not as a substantive factor which can be founded on by itself, notwithstanding Lord Clyde's reference in *Smith v Bank of Scotland* 1997 S.C. (HL) 111 at [121] to "the broad principle in the field of contract law of fair dealing in good faith" and the observation of Leggatt J. in *Yam Seng* at [130] that *Smith* was "strong authority for the view that Scottish law recognises a broad principle of good faith and fair dealing". In *Yam Seng* the judge held that traditional English hostility towards a doctrine of good faith was misplaced and that an implied duty of good faith could support more specific implied terms which reflected the specific contractual matrix.

Background

Under a written distribution agreement the defenders, an English company controlled by P, had granted the pursuers, a Singaporean company controlled by T, exclusive distribution rights in South East Asia for a branded fragrance. The judge described the contract as essentially between these two very experienced businessmen. P had approached T on the basis that he had recently signed an exclusive three year worldwide licence agreement with Nike/Manchester United to manufacture and sell Manchester United fragrances (although in reality his negotiations were still subject to contract) and set out a timetable for the availability of products which proved for certain of those products to be aspirational rather than realistic. He also represented that licences to import these products into China would be granted even though he knew nothing about the licence registration process. These representations undermined the relationship and were the cause of the eventual breakdown.

An extremely brief written agreement was prepared by P and T, apparently without legal advice, in which P purported to grant exclusive distribution rights to T for specific countries for a 12-month period at specified prices, with an obligation on P to ship orders promptly.

There were, inevitably, delays by P in shipping the orders requested by T which in turn caused T difficulties with his own agents, who were waiting for the products, and which caused tension between P and T. Subsequently, T notified P that he was ready to launch the fragrance in China and asked whether P had completed the registration of the products in China; in fact P had not made an application and did not do so before the agreement was terminated by T. In addition, P informed T that he would not supply certain products specified in the agreement but then asked T to "give back" the distribution rights for these products so that P could supply them to another distributor. When T refused, P said it was withdrawing the distribution rights for those products.

The relationship finally broke down over the pricing of products supplied to T for duty free sales which P supplied to domestic distributors at a lower price, contrary to an understanding that duty free products would be cheaper; P had falsely informed T that domestic prices would be increased when they were not. T terminated the agreement and claimed damages on the basis that P had breached the agreement by failing to ensure prompt shipping of orders placed by him, by undercutting the duty free prices agreed with him by offering the same products for sale at a lower price in the domestic market of the same territory and by providing false information on which P knew T was likely to rely in marketing the products. T also pled that there was an implied term of the agreement that the parties would deal with each other in good faith which was captured in two more specific implied terms, that P would not offer false information on which T would rely to its detriment and that P would not approve a domestic retail price for a product which undercut the duty free price.

Decision

The judge was faced with contradictory oral evidence from T and P but, as the business dealings are well documented, he approached the evidence on the basis that, as in almost every case where there was a contemporaneous documentary record, the documents provided the best evidence of what happened. The judge found that the delays in delivery had not deprived T of substantially the whole benefit of the contract so they did not justify termination of the agreement. However, he did find that P's withdrawal of T's distribution rights for certain products was a repudiatory breach which entitled T to terminate the agreement.

The judge doubted that English law had reached the stage where a requirement of good faith as a duty implied by law, even as a default rule, would be implied into all commercial contracts. However, he added that there would be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties. Following *Attorney General for Belize v Belize Telecom Ltd* [2009] 1 W.L.R. 1988 at 1993–5, the process of implication had been analysed as an exercise in the construction of the contract as a whole and Lord Hoffmann had characterised the traditional criteria, not as a series of independent tests, but rather as different ways of approaching what was ultimately always a question of construction: what would the contract, read as a whole against the relevant background, reasonably be understood to mean?

The judge said at [134] that in commercial contracts the relevant background against which contracts were made included not only matters of fact known to the parties but also shared values and norms of behaviour. Some of those were norms that commanded general social acceptance; others might be specific to a particular trade or commercial activity; others might be more specific still, arising from features of the particular contractual relationship. Many such norms were naturally taken for granted by the parties when making any contract without being spelt out in the document recording their agreement. In *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd's Rep. 61, Lord Hoffmann had said at [68] that parties "contract with one another in the expectation of honest dealing", and that

"in the absence of words which expressly refer to dishonesty, it goes without saying that underlying the contractual arrangements of the parties there will be a common assumption that the persons involved will behave honestly."

The judge continued at [138] that, in addition to honesty, there were other standards of commercial dealing which were so generally accepted that the contracting parties would reasonably be understood to take them as read without explicitly stating them in their contractual document. A key aspect of good faith was the observance of such standards. Put the other way round, not all bad faith conduct would necessarily be described as dishonest. Other epithets which might be used to describe such conduct include “improper”, “commercially unacceptable” or “unconscionable”.

Interestingly, the judge also said at [139] that a further aspect of good faith which overlapped with honesty was “fidelity to the parties’ bargain”. The central idea was that contracts could never be complete in the sense of expressly providing for every event that might happen. To apply a contract to circumstances not specifically provided for, the language must accordingly “be given a reasonable construction which promotes the values and purposes expressed or implicit in the contract.”

In outlining the principle of good faith, the judge said at [144] that although its requirements were sensitive to context, the test of good faith was objective in the sense that it depended not on either party’s perception of whether particular conduct was improper but on whether in the particular context the conduct would be regarded as commercially unacceptable by reasonable and honest people.

At [155] he held that it was clearly implied that P would not knowingly provide false information on which T would rely since this would plainly infringe the core expectation of dishonesty. In relation to the implied term affecting duty free sales he found that in the context, and in particular the industry assumption that domestic prices would be higher than duty free, the parties would have understood and expected that their obligations would reflect that assumption without needing to spell it out. At [171] the judge concluded that while T had not established that P agreed to sell domestic products at a lower price, P’s conduct in misleading T about the domestic price having been increased, struck “at the heart of the trust which is vital to any long term commercial relationship” and was a repudiatory breach of contract.

Conclusion

Leggatt J. commented at [124] that English law was swimming against the tide in refusing to recognise a general obligation of good faith. It will be refreshing to world weary commercial litigators to see a judge emphasising an expectation of honest dealing, even if it might come as a surprise to commercial clients. While there is no Scots authority for the implication of a duty of good faith in commercial contracts it is tempting to imagine such a duty being applied to certain large institutions such as banks or local authorities in their commercial dealings with parties who enjoy less bargaining power.