

## **Leap of Faith: Is English law heading towards a general contractual duty of good faith?**

There is a generally accepted legal principle that, outside of certain particular situations (e.g. partnerships), English law does not recognise a general implied contractual duty to act in good faith. Although there will normally be remedies available where one party actively lies to the other, there has been a wariness about going further and imposing a more active duty of fair dealing which might, for example, require a party to unilaterally disclose information which could be to its disadvantage.

However, the recent High Court case of *Yam Seng PTE Ltd v International Trade Corp Ltd* suggests that a fundamental change in this area may be occurring.

### **Facts**

Yam Seng PTE Ltd (“YS”) entered into a distribution agreement with International Trade Corp Ltd (“ITC”) in May 2009, pursuant to which ITC granted YS exclusive rights to distribute various Manchester United FC branded fragrances and toiletries in certain defined areas.

After entering into the agreement the relationship between YS and ITC steadily deteriorated. Among YS’ specific complaints were late delivery of products, refusal to supply certain products which YS had already incurred expenditure in marketing, and allowing YS’ prices to be undercut.

YS also alleged that ITC had provided numerous pieces of false information. In particular, it claimed that during preliminary negotiations for the distribution agreement ITC represented that it had already obtained the necessary licence agreement for the products it was intending to distribute, when in fact it did not do so until May 2009.

### **The Consequences**

YS sought to terminate the contract and brought an action for damages against ITC. As well as relatively standard claims such as misrepresentation, YS also claimed that there was an implied term in the distribution agreement that the parties would deal with each other in good faith.

The court considered this good faith argument in detail, with the judge commenting that this was perhaps the first time the issue had ever been analysed in any depth by an English court.

The judge noted the main reservations generally raised against implying general duties of good faith/fair dealing into commercial contracts, namely: (i) English law generally steered clear of overarching principles in favour of incremental, more specific solutions; (ii) this would

conflict with the ethos of individualism and freedom of contract underpinning English commercial law; and (iii) introducing this type of duty created unacceptable levels of contractual uncertainty.

However, the judge noted that English law was somewhat isolated globally in its position on this issue. By extending the accepted principle that English law would allow the courts to imply terms into contracts *based on the presumed intention of the parties*, it was in fact possible to argue that a general duty of good faith should be implied into English contract law.

The scope of any such duty would be fact specific however – this was not an attempt to apply partnership or fiduciary obligations into all commercial contracts. The key in each case was *“whether in the particular context the conduct would be regarded as commercially unacceptable to reasonable and honest people”*. In some cases the application of the duty might be relatively insignificant, in others – such as more “relational” contracts involving ongoing joint venture arrangements – it would go farther and *“involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties’ understanding”*, based on concepts of honesty and fidelity to the parties’ bargain.

In this particular case, the judge suggested that there was an implied duty of honesty in the provision of information and – although there were other important factors in the judgment – the fact that ITC gave YS information about pricing on which it knew YS would rely and which it knew was false therefore constituted a repudiatory breach of the distribution agreement.

## **The Lesson**

It is hard to say with any certainty exactly what the effect of this judgment will be. Although English law has never recognised a general duty of good faith or fair dealing before, without using those labels the courts have generally (albeit not uniformly) tried to reach decisions which do not reward parties who have acted in a way which might generally be regarded as commercially unacceptable.

At one level this judgment could be regarded as an attempt to do no more than refine that implicit principle into a general doctrine of good faith, without materially extending the scope of the law. (Indeed, it might well have been possible to deal with the case and achieve the same result using existing causes of action such as misrepresentation, without considering a general duty of good faith.) However, the judgment suggests the new principle may go further than this – the judge was clearly of the view that in some longer term contracts *“the relevant background expectations may extend further to an expectation that the parties will share information relevant to the performance of the contract such that a deliberate omission to disclose such information may amount to bad faith”*.

At a more political level, one might suggest that this decision is an attempt, consciously or unconsciously, to bring English commercial law more closely into line with other legal systems. In particular, it could be seen as a precursor to the possible introduction of an EU driven Common European Sales Law, whose central concept of a duty of fair dealing has caused significant consternation amongst English lawyers.

All in all, it is fair to say therefore that the legal position in this area is a little uncertain. Those negotiating and entering into commercial contracts, particularly longer term arrangements such as joint ventures and distribution agreements, will need to be aware that they cannot afford to look solely at the specific written terms and conditions of their contract to determine their rights and responsibilities.

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