Singapore Academy of Law

26 April 2013

COMING TO TERMS WITH GOOD FAITH

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Thank you for inviting me to give this lecture and for your kind words of introduction. I would like to say what a pleasure it has been to attend the Joint Conference of the Chancery Bar Association and the Singapore Academy of Law over the last two days and to hear the quality of the contributions. Two phrases resonate with me: (1) the word "hub", representing Singapore's ambition to become the legal hub of South East Asia and (2) the desire of many Singaporeans to look over the horizon. The subject of good faith in contract law, about which I am going to speak, is one which I believe presents a considerable challenge for commercial law. I feel that I could not have chosen a more appropriate audience.

Moreover, the Joint Conference has performed an important function in bringing judges and lawyers in our two jurisdictions together. Even in the comparatively cerebral area of financial, property and business litigation, we can benefit from meeting together in terms of expanding our cultural horizons. In the United Kingdom, we have commercial cases between British citizens and other persons of Asian origin. In our fact-finding role, and in our role as appellate judges interpreting findings of fact, we need to understand Asian cultural values and the Asian way of life. In addition, when judges write their judgments they have to think about their

audience. It is good to be reminded that sometimes our audience is far away and that we need to say what we say in a clear and internationally accessible way.

I have chosen as my title "Coming to terms with good faith" with care for two reasons. First, it came to my notice that, rightly or wrongly, parties are increasingly inserting into their contracts governed by English law obligations to do things in good faith. Second, I wanted to use this lecture to try to take stock of where we are in the jurisprudence on express contractual terms of good faith in England and Wales and here in Singapore.[1] I shall be talking about normal commercial contracts, and not contracts such as employment contracts, to which special principles may apply.

In addition, at the end of the lecture I want to get out my crystal ball and offer some ideas about where English law at least may be heading. I should say that I am discussing these matters outside a court context. I would need to start again if these points were to be argued in any case.

First, to make good the point that parties are increasingly using good faith obligations, let me give you two examples:

(a) Derivatives: The ISDA Master Agreement[2] contains a number of good faith duties. In particular, clause 6(f) provides for good faith in reaching agreement on the valuation of a rate of exchange; clause 9(h)(i)(2) provides for good faith in reaching agreement on fair market value; clause 14 (definition of

[1] At this point I would like to express my thanks to Ekaterina Finkel, then my Judicial Assistant in the Court of Appeal, for her excellent research into this subject, and to Kristy Tan, partner, Allen & Gledhill, who kindly assisted me in relation to Singapore. However, the views expressed in this lecture remain my own.

[2] The first standardised terms of business for derivative transactions issued by ISDA were issued in 1992. The terms as to the consequences of early termination were revised in 2002.

"Applicable Deferral Rate") provides the duty to select a bank in good faith; clause 14 (definition of "Close-out Amount") provides for good faith in reaching agreement on the valuation of the close-out amount; clause 14 (definition of "Termination Currency Equivalent") provides a duty to select a foreign exchange agent in good faith; clause 14 (definition of "Unpaid Amount") provides for good faith in reaching agreement on fair market value. All these references to good faith raise the question: if good faith is such an uncertain and unruly concept, why is it used in ISDA contracts? They govern transactions of a ruthlessly competitive and fast-moving kind.

(b) Construction contracts: This is a very different example. Good faith clauses are now a feature of a number of standard form construction contracts, and they have been adopted as part of an attempt to move away from an adversarial approach to contract law. Importantly, in this context the parties agree to co-operate. Thus, for example, the third edition of the standard form New Engineering Contract (NEC) states: "The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in the spirit of mutual trust and co-operation." More significantly, the Joint Contracts Tribunal incorporated an express obligation of good faith: "The Parties shall work with each other and with other project team members in a co-operative manner, in good faith and in a spirit of trust and respect."

What is required to show good faith in a particular term will be a matter of the construction of the contract. The expression "good faith" has several meanings. Contracting parties who choose to use this expression would do well to specify the meaning which they intend to apply in their contract. I am going to assume for the

purposes of this lecture that it has both a subjective and an objective meaning: i.e. that, to comply with the obligation of good faith, a contracting party must act in a manner which the contracting party reasonably believes is honest and that his conduct must be such as would be considered to be fair and reasonable by right-thinking people engaged in the same business. So, on this basis it has both a subjective and an objective meaning. Conduct which is fair and reasonable will of course in some cases have to take the position of the other contracting party into account. That is, as they say, the rub. It is a theme to which I will return towards the end of this lecture.

The growing use of good faith clauses struck me as altogether surprising because as is well known, in recent times, English law has been very resistant to a general or overarching concept of good faith.

This was not always the position. In 1766, Lord Mansfield sought to broaden the application of the principle of good faith (in insurance contracts) to all contracts. He declared that:

> "[t]he governing principle is applicable to all contracts and dealings. Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary. But either party may be innocently silent, as to grounds open to both, to exercise their judgment upon." [3]

[3] *Carter v Boehm* (1766) 3 Burr.1905,1910.

However, this approach did not survive. The general attitude of the courts and legislators in England in the 19th and early 20th centuries was one of *laissez-faire,* freedom of contract and party autonomy**.** This development was paralleled in civil law countries, such as France, as well as in the United States.[4] The sanctity of contract gave priority to the values of predictability and foreseeability. The primary approach to the interpretation of contracts was also one of determining the meaning of contracts by reference to the ordinary meaning of words, abstracted from their context.

However, as Mr Chan Sek Keong SC, the former Chief Justice of Singapore, reminded us this morning, the emphasis on freedom of contract led on occasions to harsh results. In some countries, but not the United Kingdom, legislators sought to restore the balance by adopting a general duty of good faith in contracts. The idea was that it would allow sufficient discretion to the courts to intervene if justice so required. Good faith would serve two functions: first, as an interpretative tool in order to enforce the *real* bargain of the parties, the second (perhaps less accepted at the time) as a substantive duty to cooperate.

However, England did not follow such an approach. Rather, unfair situations called for targeted interventions. In 1989, Bingham LJ (later Lord Bingham) famously observed:

[4] Article 1134 of the French Code Civil states that between the parties 'contract is law'. In the US, the *Restatement First* embodied a formalistic approach to contract interpretation and gap-filling. Indeed at the heart of the formalistic approach to contract interpretation was 'the plain meaning' rule and the 'parol evidence rule'. It was said then that “commercial stability requires that parties to a contract may rely upon its express terms without worrying that the law will allow the other party to change the terms of the agreement at a later date.” Dubroff, *Implied Covenant of Good Faith* (2006), p.569 citing the case of *Baker v Bailey*, 782 P.2d 1286, 1288 (Mont. 1989).

> "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...English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness."[5]

So there is no general duty of good faith but rather a series of piecemeal solutions. We can find many instances in contract law where, while not using the concept of an obligation to act in good faith, the law often comes to the same sort of conclusions it would have reached via the duty to mitigate. In addition a party may be able to claim as part of his damages for breach of contract the loss resulting from expenditure incurred before the contract if this was within the reasonable contemplation of the parties[6]. Likewise we have a principle that onerous and unusual terms in a contract must be specifically drawn to a party's attention before they can be incorporated into a contract. It may be that the law of unjust enrichment or the principles of equity have to be employed.

As I have said, substantially the same result may be achieved in these situations as if there were an obligation to act in good faith. So we can agree with Lord Hope that:

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[5] *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433 Bingham LJ at [439].

[6] *Anglia Television Ltd v Reed* [1972] 1 QB 60.

> "The preferred approach in England is to avoid any commitment to over-arching principle, in favour of piecemeal solutions in response to demonstrated problems of unfairness."[7]

So where is the hostility of English law to a general concept of good faith to be found? The best example is the decision of the House of Lords in *Walford v Miles*,[8] decided in 1992. This rejects the idea that there can be an implied duty of good faith and seems to throw rather a lot of cold water generally on the subject of good faith.

The essential fact in *Walford v Miles* was that the defendants had entered into an exclusivity agreement with the plaintiffs, ie they had agreed to negotiate with them for the sale of the business on an exclusive basis. The defendants subsequently broke off negotiations and the question was whether they were liable for damages for breach of an implied term to negotiate in good faith. It was argued that the defendants could not terminate the negotiations provided that they honestly believed that they had a good reason to do so.

There was one reasoned speech, that of Lord Ackner, with which the other members of the House agreed. The House effectively rejected a dictum of Lord Wright in *Hillas v Arcos Ltd* [9] that there could be a contract to negotiate. Lord Ackner held:

> "The reason why an agreement to negotiate, like an agreement to agree, is unenforceable, is simply because it lacks the necessary certainty. The same does not apply to an agreement to use best endeavours. This uncertainty is demonstrated in the instant case by the

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7 *R (European Roma Rights) v Prague Immigration Office* [1995] 2 AC 1 at 59.

8 [1992] AC 128.

9 (1932 147 LT 505, 515.

> provision which it is said has to be implied in the agreement for the determination of the negotiations. 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 a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. Mr. Naughton, of course, accepts that the agreement upon which he relies does not contain a duty to complete the negotiations. But that still leaves the vital question - how is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an "agreement?" A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies. In my judgment, while negotiations are in existence either party is entitled to withdraw from those negotiations, at any time and for any reason. There can be thus no obligation to continue to negotiate until there is a "proper reason" to withdraw. Accordingly a bare agreement to negotiate has no legal content."

This is a robust decision. As a result of *Walford vMiles*:

- A mere agreement to negotiate is too uncertain to be enforceable;
- A mere agreement to negotiate in good faith is no better. It is also too uncertain to be enforceable. The good faith relied on was purely subjective. The courts cannot determine when a person is acting in subjective bad faith in terminating negotiations since he is always free to exercise the power to withdraw from negotiations as he thinks fit. The right of a party to act in his own interests makes the duty to act in good faith meaningless and deprives it of any content.

However, the House of Lords was not saying that every agreement to negotiate was unenforceable.   It would be enforceable if it was, for example:

- an agreement to negotiate for a particular period or
- an agreement to use reasonable endeavours to come to an agreement as a result of the negotiations.

The latter is likely to be indistinguishable in practice from an agreement to negotiate in good faith. However, one part of the reasoning of the Lord Ackner if taken literally would rule out any kind of obligation of good faith because the duty to negotiate in good faith is described as inherently repugnant to the adversarial position of the parties when involved in negotiations. That amounts to saying that the right to withdraw from negotiations, or, it would follow, any other right, could not be qualified by a good faith obligation because the right is one which is always exercisable by a contracting party in his own interests.   That would rule out any restriction on the right of a party as to how he exercises some particular right.

In my view, to read *Walford v Miles* in that way is to go far too far. We now know from a number of subsequent cases that if a party has some unilateral right under a contract, the court may find that he must exercise the rights in a particular way, whether it be reasonably or not perversely or honestly. Freedom of contract is also freedom to qualify the way contractual rights may be exercised. I will come to those cases in a moment but just now I ask you to notice that the decision in *Walford v Miles* is driven by two things: the need for enforceable contractual obligations to be

certain, and the right of a party to a contract to exercise his rights in his own best interests.

The next question is this: would the answer in *Walford v Miles* have been different if the obligation had not been one simply to negotiate but to exercise some contractual right and the agreement expressly or by implication required this right to be exercised in a particular manner which takes into account to greater or lesser extent the interests of the other contracting party?

The answer in terms of principle is that there is an important difference between the case in *Walford v Miles* and the case where there is a clause in the parties' agreement and it is this: for the court to say that such an agreement is unenforceable would be to frustrate the purpose of the agreement and that is a matter to which I want to return. The answer in the authorities (and these are the cases I alluded to a moment ago) is that there are cases *where a contracting party has a right and the courts have imposed an obligation on him to exercise that right in an honest or not unreasonable way.*[10]

I will give three examples.

My first example is the decision to which I was a party in *Lymington Marina Ltd v MacNamara.*[11] This was an unusual case because it concerns licences for berths for boats on a marina. The first defendant held a 98-year licence. He wanted to execute sub-licences in favour of his brothers for two successive periods. The approval of the landlord was necessary. We held that the landlord could only refuse to grant its

[10] For a further analysis of these cases, see Hooley, *Controlling Contractual Discretion* (2013) 72 Camb LJ 65.
[11] [2007] Bus L R Digest D29.

approval to the grant by a tenant of a sub-licence on grounds that related to the third party and his suitability to use the berth.

There was then a question whether there was any further restriction. Another sub-clause of the same clause of the licence enabled the landlord to refuse permission to assign in its absolute discretion. Those words did not apply to the power to grant or withhold approval to a sub-licence for a limited period.

We held that the power to grant or withhold approval was, therefore, not one which the landlord could exercise at his sole discretion. We further held that on the true interpretation of the licence the power was required to be exercised honestly and not arbitrarily. We preferred not to say, as the judge had done, that the landlord had also to act in a manner which was not unreasonable in the *Wednesbury* sense as this would import notions of public law into contract law. This raises a separate issue on which views may differ but which I do not have time to discuss today. The landlord had also an obligation to consider the application placed before it. These obligations, therefore, qualified the landlord's contractual obligation to approve sub-licences.

Lymington Marina followed in particular two earlier decisions, *The Product Star*[12] and *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2).*[13] *The Product Star* contains an important dictum by Leggatt LJ recognising that contractual discretions must be exercised in good faith and for a proper purpose. However, I take the *Gan* case as my second example. In that case, the Court of Appeal held

[12] [1993] 1 Lloyd's Rep 397.
[13] [2001] 2 All E R (Comm) 299.

that, where a reinsurer had a contractual discretion to withhold approval to a proposed settlement by the re-insured, a term was to be implied a term preventing the re-insurer from acting arbitrarily and requiring him to act in good faith. He also had to consider the facts giving rise to the particular claim, and to act without reference to factors which were extraneous to the subject-matter of the reinsurance. This case, too, is inconsistent with the idea that a party can always exercise his contractual rights solely in his own interests and as he thinks fit.

My third example is *Socimer International Bank Ltd v Standard Bank London Ltd.*[14] The facts were that on closing out forward exchange contracts, the seller had to value, and give credit for, securities belonging to the buyer which it held. The Court of Appeal held that the discretion was limited as a matter of necessary implication "by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality."[15] All the further qualities mentioned by the Court of Appeal may in fact be encompassed within the concept of good faith.

These cases to my mind represent a turning point in our understanding of the impact of good faith in contract. They demonstrate that there is nothing inherently unenforceable or inherently impossible in law about an obligation to act in good faith.

However, they are all examples of unilateral rights. They are not the cases where the parties' performance of their contractual obligations has been subjected to a

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[14] [2008] 1 Lloyd's Rep 558.

[15] at [66] per Rix LJ.

duty to act in good faith. For authorities in which where the courts have had to consider whether parties' *performance* obligations were subject to any requirement to act in good faith, we have to look at two recent cases. These disclose different trends.

The first of these two cases is *Compass Group UK and Ireland Ltd v Mid-Essex Hospital Services NHS Trust Ltd*. [16] In this case, an NHS hospital trust ("the Trust") and a supplier of cleaning and other services entered into a contract for the provision of catering services. Under the contract the Trust had the right to award service failure points and make deductions from its monthly payments accordingly. The Trust had awarded itself an extraordinary number of service failure points for trivial failures, including an award of service failure points which led to a deduction of £84,540 for one-day old chocolate mousse which had passed its sell-by date. At trial the case for the supplier turned (so far as relevant) on two issues. The first was whether the Trust was under an implied obligation not to exercise its contractual discretion to award service failure points in a manner which was "arbitrary, irrational or capricious". The second was whether, on its true construction, clause 3.5 of the contract imposed upon the parties a general duty of good faith.

Clause 3.5 provided that the parties must:

> "co-operate with each other in good faith and to take all reasonable action as was necessary for the efficient transmission of information and instructions and to enable the Trust or any beneficiary to derive the full benefit of the contract."[17]

[16] [2012] EWCA Civ 781.
[17] *Compass Group UK and Ireland Ltd (trading as Medirest) v Mid Essex Hospital Services NHS Trust* [2012] EWHC 781 (QB), [23].

The trial judge, Cranston J, was impressed by this clause. He reviewed a number of authorities, including Australian cases, which I will not have time to discuss in this lecture. The judge also held that the contractual discretion could not be exercised in a manner which was arbitrary, irrational or capricious. With regard to the duty to co-operate in good faith in clause 3.5, the judge held that "good faith" bore an objective, as well as a subjective, meaning and that the duty primarily encompassed faithfulness to the common purpose of the contract. He added that fair dealing, and acting consistently with the parties' justified expectations, were "in a sense, corollaries of that".

The Trust appealed. The Court of Appeal came to a different view on both these points. The Court of Appeal held that the contractual discretion to award service points was free from any obligation not to exercise it arbitrarily, capriciously or irrationally as this line of authority (the cases like *Gan* and *Socimer*) which I have already discussed) could only apply if there was a discretion which involved an assessment or choosing from a range of options rather than having to decide whether to exercise an absolute right, which they considered the discretion to be. I have difficulty with this distinction because it does not sit easily with *Lymington Marina* which was not cited to the Court. As you will recall in that case, there was no range of options, simply a yes/no decision to approve the grant of a sub-licence.

However, the Court also expressed the view that it would be difficult to exclude the obligation to exercise a discretion other than arbitrarily, capriciously or irrationally. That may revive the argument that a good faith obligation is inherent in a contractual

relationship in any event, but I do not have time to follow up that line of argument in this lecture.

As to the meaning of clause 3.5, the Court of Appeal came to a different conclusion from the trial judge. It held that the obligation of good faith was not an independent obligation but one focused on the two stated purposes, namely the efficient transmission of information and instructions and enabling the Trust or any beneficiary to derive the full benefit of the contract. [18] Accordingly, it did not apply to the award of service failure points. In reaching this conclusion the Court re-emphasised the point that there is "no general doctrine of good faith in English contract law".[19] As it happened, the award of excessive service failure points was caught by another provision in the contract.

The second of the two recent cases about good faith and performance obligations is the decision of the High Court, *Yam Seng Pte v. International Trade Corporation Ltd.*[20] This was decided between the trial and the appeal in *Compass*. The facts were that a Singaporean distributor brought a claim for breach of contract against its English supplier. Leggatt J (not the Leggatt LJ in *The Product Star*) held that the parties had a number of implied obligations under a distribution agreement, for example, not knowingly to give false information. He further held that these obligations were aspects of an implied obligation to perform the contract in good faith. He described English law as "swimming against the tide":[21] civil law, the USA,

[18] *Mid Essex*, per Jackson LJ at [106].
[19] *Mid Essex,* per Jackson LJ at [105].
[20] [2013] EWHC 111 (QB).
[21] at [124].

Canada, New South Wales and Scottish law all recognise a general doctrine of good faith.

This decision has attracted a great deal of attention in the United Kingdom. It goes into the authorities in greater detail than is possible in this lecture. I propose simply to pull out certain points in it.

The judge addressed the relationship between good faith and implied terms. He observed that the modern case law on the construction of contracts has emphasised that contracts, like all human communications, are made against a background of unstated shared understandings which inform their meaning.[22] That "background" consists of shared values,[23] norms of behaviour[24] and expectations of honesty.[25]

In the course of this discussion, the judge particularly referred to relational contracts, that is, agreements to govern a long-term relationship such as distribution agreements. The judge took the view that these contracts involve high expectations of loyalty which are not legislated for in the express terms of the contract but which can be implied as a matter of business efficacy. The judge also referred to cases on contractual discretion. The judge concluded, perhaps surprisingly, that "there is in my view nothing novel or foreign to English law in recognising an implied duty of good faith in the performance of contracts".[26]

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22 at [133].
23 at [134].
24 at [134].
25 at [135].
26 at [145].

The judge went on to make observations about the hostility of English law to the duty of good faith. In particular he saw the duty as case-sensitive and that that was consistent with the common law method. In his view it would create no more uncertainty than was inherent in the process of contractual interpretation. For my own part, that treats somewhat too lightly the problems of diminished certainty or the amount of time that might have to be spent in some cases in resolving disputes as to the application of the good faith clause.

Nonetheless, this decision is undoubtedly a welcome *tour de force* on good faith, and an important case to watch. It is not clear whether it will be appealed as the critical terms were in fact specific terms which could be implied in any event under the general principles applying to the implication of contractual terms. The Court of Appeal in *Compass* mentioned the decision in *Yam Seng*, but did not discuss it in any detail.

Before I turn to my concluding section, I shall consider some recent developments in the law of Singapore.

LAW OF SINGAPORE

I am interested to see that Singapore contract law has also been undergoing change in recent years in the context of good faith clauses. First, in *Ng Giap Hon v Westcomb Securities Pte Ltd and Others,*[27] the Singapore Court of Appeal refused to imply a general duty of good faith. The case involved an agency agreement under which a

[27] [2009] 3 SLR (R) 518.

stockbroking company authorised its agent to trade and deal in securities in return for a commission. The agent sued the company for commissions which he stated were due to him for certain clients but which the company had intercepted. He stated that in doing so the company breached its duty to act in good faith, a duty that he said was implied.

Phang JA, giving the judgment of the Court, analysed separately the possibility of a term implied in law and the possibility of a term implied in fact.[28] He held that "implying a 'term implied in law' into a contract involved broader policy considerations. It also established a precedent for the future. Put simply, the implication of such a term into a contract would entail implying the same term in the future for all contracts of the same type."[29] This required extreme caution. As he held that the "doctrine of good faith is very much a fledging doctrine in English and (most certainly) Singapore contract law", he did not endorse an implied duty of good faith.

Phang JA also refused on the facts to imply a term that the company would not do anything to prevent the agent from earning his commission. He applied the usual test for implying a term in a particular factual matrix, namely necessity. The threshold for necessity is a high one. Insisting on the principle that judges will not rewrite contracts on the basis of their own sense of justice, Phang JA found that an implied term of good faith was not necessary in this case.

The decision was a disappointment to some who thought that there was a missed opportunity to introduce the doctrine of good faith into Singapore law.[30]

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28 at [35] to [40].

29 at [46].

30 See, for example, Joseph, *A Doctrine of Good Faith in Singapore?* [2012] Singapore Journal of Legal Studies 416- 440.

Second, and most recently, Singapore courts have upheld an express duty to negotiate in good faith. *HSBC Institutional Trust Services (Singapore) Ltd (Trustee of Starhill Global Real Estate Investment Trust) v Toshin Development Singapore Pte Ltd* [31] concerned a rent review mechanism in a lease agreement under which the rent for each new rental term after the first rental term had to be determined by agreement between the landlord and tenant, or failing agreement, by designated valuers. The clause provided that parties "shall in good faith endeavour to agree on the prevailing market rental value of the Demised Premises" prior to the appointment of the designated valuers. V.K. Rajah JA, giving the judgment of the Court, held:

> "In our view, notwithstanding Lord Ackner's statement in *Walford* (at 138) that "[a] duty to negotiate in good faith is … unworkable in practice", that case does not have the effect of invalidating an express term in a contract which employs the language of good faith (see [40]–[41] below). As a preliminary observation, we are of the view that a valid distinction can be drawn between the pre-contractual negotiations in *Walford* and the "negotiations" between the Parties under the Rent Review Exercise in the present case."[32]

The Singapore Court of Appeal upheld the good faith clause. Interestingly, it considered the broader impact of upholding a principle of good faith in contracts. It held:

> "In our view, there is no good reason why an express agreement between contracting parties that they must negotiate in good faith should not be upheld. First, such an agreement is valid because it is not contrary to public policy. Parties are free to contract unless prohibited

[31] [2012] 4 SLR 738.
[32] at paragraph [37].

> by law. Indeed, we think that such "negotiate in good faith" clauses are in the public interest as they promote the consensual disposition of any potential disputes. We note, for instance, that it is fairly common practice for Asian businesses to include similar clauses in their commercial contracts…We think that the "friendly negotiations" and "confer in good faith" clauses … are consistent with our cultural value of promoting consensus whenever possible. Clearly, it is in the wider public interest in Singapore as well to promote such an approach towards resolving differences. The second reason why we are of the view that "negotiate in good faith" clauses should be upheld is that even though the fact that one party may not want to negotiate in good faith (for whatever reason) will lead to a breakdown in negotiations, no harm is done because the dispute can still be resolved in some other way." [33]

Thus the Singapore Court has expressly sought to integrate the concept into Singapore's legal and cultural framework. In the result, this case develops the law in a not dissimilar way to that in which it has been developed in some of the more recent English cases to which I have referred.

WHAT DOES THE FUTURE HOLD?

You may recall the story of the ancient English king, King Canute. He set his throne by the sea shore and commanded the tide to halt and not wet his feet, but of course the tide failed to stop. In fact this was a subtle ploy to show his courtiers that they were fools to think he was all powerful and that he was well aware their flattery. However, the story is usually cited as an example of the failure to face reality.

The story has some resonance as English law engages with external influences and considers whether to make changes or hope to ride out the forces of change. The strategy has sometimes been successful but sometimes it has led to a retreat of a stout

[33] at paragraph [40].

party as in the recent unsuccessful battle in the Supreme Court over the reception of article 8 jurisprudence in the context of social housing. The Supreme Court decided in the end that it had to accept the principle of Convention case law that a person, who was about to be evicted in accordance with the landlord's rights under domestic law, had to have an opportunity to be able to pursue a serious defence in court that the eviction would interfere with his right to respect for his home in a disproportionate way.[34]

As many speakers during the conference remarked, English law is these days subject to global influence, particularly new legislation coming from the European Union.

The requirement of good faith is prevalent in the majority of the civil law systems of the European Union. Unsurprisingly therefore, the duty of good faith has been incorporated into legislation of the European Union. Most notable (and controversial at the time) is the example of the Unfair Terms in Consumer Contracts Regulation 1999. Regulation 5(1) states that a contractual term will be "unfair" if "contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer." Recital 16 of the preamble to the directive giving rise to these regulations states that the requirement of good faith is satisfied where the consumer is equitably and fairly dealt with. Fairness is to be determined by reference to the subject-matter, circumstances of the case and other terms of the contract. The good faith requirement here relates to the conduct of the parties, rather than as an interpretative principle, and the House of

[34] *Manchester City Council v Pinnock* [2011] 2 AC 104.

Lords has confirmed that it required both procedural and substantive fairness in contracting.[35]

A further example is the Commercial Agents Directive[36] which sets the standard of the agents' duties to their principals according to which an "agent must... act dutifully and in good faith".[37] The European Court of Justice has also referred to "good faith" as a "principle of civil law".[38]

Most recently, article 2 of the proposed Common European Sales Law imposes a duty on each party to act in accordance with good faith and fair dealing; a duty which cannot be excluded.[39] Good faith and fair dealing is also used in clauses on the duty to provide information in commercial contracts, mistake, fraud, contractual interpretation, the implication of terms, and unfair contract terms.

The negative side of legislation from the EU is that it may on a worst case scenario require us to abandon some of the principles of the common law. One of the ways of countering this risk is indeed to develop our own body of case law which can be used to influence the development of new laws in the EU. There is probably little that we can say about the requirements of good faith in English law at the present time because we have no coherent body of law to offer. Developing some principles of good faith would, therefore, strengthen the common law in the development of EU

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[35] *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52.

[36] 1986/653/EEC.

[37] See also Financial Services Distance Marketing Directive 2002/65/EU referring to 'principles of good faith in commercial transaction' in setting information which a supplier must provide to a consumer before concluding the contract; and Unfair Commercial Practices Directive 2005/29/EU which defines 'unfair commercial practice' by (indirect) reference to good faith.

[38] C-489/07 *Messmer v Kruuger* [2009] ECR I-7315 at [26].

[39] Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law Com (2011) 635 final, Annex I, CESL Proposal, Annex I, article 2 CESL.

law but those principles would of course have to be consistent with the ethos of the common law.

On the positive side I would add that it should not be supposed that the influence of the laws of other member states is always a negative matter: there are matters which we can learn from civil systems and ideas that we can borrow, such as the concept of proportionality, which is now being used in many areas of English law. Comparative study of legal systems and laws can help us widen our horizons as to what makes for good law. It is like learning new languages. As Goethe said, "A man who has no acquaintance with foreign languages knows nothing of his own".[40]

The principal objection to introducing a concept of good faith into English law is that it would bring with it uncertainty, delay and expense if the question what the concept meant in any given case had to be litigated. But I have only been considering the question of contracts where parties have opted for an obligation of good faith. Where they do so expressly, they have really only themselves to blame if they do not provide sufficient guidance to enable them to work out when there has been a breach.

There is also the principled answer to this point, namely that certainty is not a trump card that defeats all other principles in contract law. Of course certainty and predictability are qualities of English commercial law but they are not the be-all and end-all of contract law. In the *Golden Strait* case,[41] the issue was whether in the assessment of damages the court could take into account matters reducing the loss but

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[40] Johann Wolfgang Von Goethe, *Maxims and Reflections* (The MacMillan Company, New York. 1906), p 154 translated by Bailey Saunders.
[41] *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha* [2007] 2 AC 353.

occurring after the renunciation of the contract. The majority thought that the "breach date rule", which excluded subsequently occurring events, had to give way to the principle that damages should simply compensate the claimant for his loss. Lord Scott, giving the leading speech, rejected the argument that this would render the law uncertain in these trenchant terms:

> "Certainty is a desideratum and a very important one, particularly in commercial contracts. But it is not a principle and must give way to principle."

Likewise, in the field of good faith clauses, certainty may have to yield in appropriate cases to the principle of giving effect to the parties' agreement in accordance with the principle of party autonomy.

Fundamentally I consider that the law is already slowly developing in a way which can accommodate the concept of good faith within contract law. Take, for example, the law of contractual interpretation. Until recently, documents were interpreted without reference to the background of fact against which they were made. Now, following the decision of the House of Lords in *Investors' Compensation Scheme Ltd v West Bromwich Building Society*,[42] courts are required to interpret documents against the background of material facts. They do this in order to ascertain the meaning which a reasonable person in the position of the parties and having the knowledge of the background which they had, or ought to have had, would give to them. Thus, in the field of interpretation of contractual documents, the courts have

[42] [1998] 1 WLR 896.

come to recognise, if they had not already recognised, that there is another important principle, alongside certainty and party autonomy, which underlies contract law, namely the need for the court where possible to give effect to the parties' reasonable expectations. This is properly regarded as a principle. The same point can be made about the implication of terms, which has been subsumed within the scope of interpretation of contracts.

I would apply the principle of giving effect to the reasonable expectations of the parties to the debate on good faith clauses in the following way. If the parties have agreed that contractual obligations should be performed in good faith, the court should so far as it can give effect to that agreement and, by doing so, to the parties' reasonable expectations.

There is strong support for this approach from one of our most outstanding commercial judges, Lord Steyn. Lord Steyn stressed the view in his Aslan Shah lecture in 1996 that, if the point in *Walford v Miles* arose again for decision, it should not be rejected out of hand. He considered that respect for the reasonable expectations of the parties made it unnecessary to adopt any general concept of good faith:

> "As long as our courts always respect the reasonable expectations of parties our contract law can satisfactorily be left to develop in accordance with its own pragmatic traditions. And where in specific contexts duties of good faith are imposed on parties our legal system can readily accommodate such a well-tried notion. After all, there is not a world of difference between the objective requirement of good faith and the reasonable expectations of the parties."[43]

[43] Lord Steyn, *Contract Law: Fulfilling the reasonable expectations of honest men* (1997) 113 LQR 433, 439.

That is very strong support indeed for the development of the concept of good faith or its equivalent, and to do so, as I would myself wish to do, within the values and traditions of the common law. There are other very eminent judges who have also supported the introduction of good faith.

I would go further. We have long since ceased to believe that there is one approach to contract law which will suit all sets of contracting parties. Where, for instance, there is an inequality of bargaining power, the courts and the legislature have now intervened and adopted or developed principles to redress the balance.

As we have seen, we have also already come part way down the path we need to go in the context of contractual discretions. The English courts now recognise that there is no inalienable right in the party entitled to the discretion to exercise the discretion in his own best interests: see the *Lymington Marina* and other cases.

Now what I say is this. We need to recognise more generally that there are some contracting situations where the parties expressly do not want to give each other the right to take decisions exclusively in their own interests. We saw this in the building contracts to which I referred at the start of this lecture. The types of contract that I have in mind are likely to be long-term contracts where the parties cannot, or do not wish, to prescribe in stone all their requirements at the date the contract is made.

Parties in these cases, as we have seen, now sometimes and maybe often expressly agree to co-operate in how they will perform the contract or indeed in reaching

agreement during the course of the contract e.g. for a revised price structure over the term of the contract. These parties are not, therefore, looking for a model of contract law which will enable them to take advantage of the other – quite the opposite. They are not expecting to be told that their agreement to co-operate is meaningless and that either party is free to exercise his contractual rights as he thinks fit.

This reasoning provides a suitable normative framework for the development of good faith. Reasonable certainty will have to be provided for in the contract. Thus the parties will probably have to provide the court with benchmarks which it can apply to determine whether there has been co-operation of the type which they desire to have.

As I see it, there could also be economic advantages in providing a more appropriate structure for co-operative arrangements. It would lead to stability in these arrangements and they may produce costs benefits as well as more secure employment. Our relatively new statutory codification of directors' duties requires directors to have regard to the long-term consequences of their action. This is some confirmation of the economic desirability of long-termism. The new principle was called "enlightened self-interest" to replace what was previously seen as the naked self-interest of companies. *Walford v Miles* was a case where great value was set on the principle of contract law of freedom to act in accordance with naked self-interest.

The time has therefore come to recognise that, while these are not vulnerable parties, there are parties who agree on good faith clauses or their near cousin, co-operation clauses, and who seek a different principle to apply to their contracts. We should recognise this expressly. We should seek to develop a body of law which will deliver

this. To do so will give our law a new option, a new flexibility which will make it more, not less, attractive in the global market place for commercial law.

I also attach considerable importance to the role of the independent judiciary in both our countries. It is crucial for judges to seek to develop the law in line with evolving commercial and social need. It is part of their responsibility to have a vision of the law as a dynamic, not a static, set of principles and rules, to see the big picture and overall trends, and to have a sharp eye for what is coming over the horizon rather than simply that which has served us well in the past.

To develop the law incrementally along the lines I have suggested will also deliver on the role and responsibility of the independent judiciary as I see it to be.

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