

# Good Faith and the Ubiquity of the ‘Relational’

## Contract

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The judgment of Leggatt J in *Yam Seng Pte Ltd v International Trade Corporation Ltd* shows the common belief that the English law of contract does not have a doctrine of good faith to be mistaken. That law does not have a general principle of good faith, but its doctrine of good faith, articulated through numerous specific duties, is more suitable for the interpretation of contracts according to the intentions of the parties than a general principle, which invites the imposition of exogenous standards. That *Yam Seng* involved a relational contract does not mean that paternalistic exogenous standards should be imposed. It means that the good faith obligations essential even to a commercial contract of this sort must be implied in order to give efficacy to the fundamentally co-operative relationship analytically essential to all contracts.

### INTRODUCTION

*Yam Seng Pte Ltd v International Trade Corporation Ltd*<sup>1</sup> maps out a direction for the development of a doctrine good faith in the English law of contract which, it is submitted, should be followed. Leggatt J’s judgment has quickly attracted considerable attention<sup>2</sup> largely because the prospect of a harmonised European law of

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<sup>1</sup> [2013] EWHC 111 (QB). Judgment was handed down on 1 February 2013. Unattributed paragraph numbers in the footnotes are references to this case.

As of 6 March 2014, *Yam Seng* had been considered in *Hamsard 3147 Limited Trading as ‘Mini Mode Childrenswear’, J S Childrenswear Limited (in liquidation) v Boots UK Ltd* [EWHC] 3251 (Pat); in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200, [2013] BLR 265 (it could have no influence on the first instance judgment of Cranston J in *Mid Essex* ([2012] EWHC 781 (QB)), which preceded *Yam Seng* by some 11 months) and in *TSG Building Services plc v South Anglia Housing Ltd* [2013] EWHC 1151 (TCC). It had been cited without discussion in a number of other cases.

<sup>2</sup> As of 6 March 2014, this Queen’s Bench judgment had been reported no less than five times, [2013] 1 All ER (Comm) 1321, [2013] 1 Lloyd’s Rep 526, [2013] BLR

contract gives impetus to the resolution of the perceived conflict between the absence of good faith in the English law and its presence in civilian laws. A number of European and international expressions of a general doctrine of good faith<sup>3</sup> are now hailed as potential remedies for an absence which has long been identified as ‘at once the most remarkable and the most reprehensible feature of the English law of contract’.<sup>4</sup>

*Yam Seng* will frustrate those who see the issues this way. It shows that the English law recognises specific duties which do the useful part of the work of good faith and that there is no need for a general doctrine. It also gives weight to the argument that the English law should recognise the ‘relational’ contract as part of its understanding of good faith. It does all this whilst, unlike a number of other significant judgments of recent vintage, actually striving to reach the right decision about liability on the facts.

### **OPTIMISM AND OPPORTUNISM IN CONTRACTUAL NEGOTIATION**

Following negotiations between Yam Seng Pte Ltd (YSL) and International Trade Corporation Ltd (ITC) begun on 23 January 2009, on 12 May 2009 ITC granted YSL the exclusive right to distribute certain cosmetics under the brand name of Manchester United, ITC maintaining that it had a licence ‘to manufacture and sell Manchester

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147, [2013] 1 CLC 662 and (2013) 146 Con LR 39, and digested in [2013] All ER (D) 227 and [2013] Bus LR D53.

<sup>3</sup> Principally the draft *Common Frame of Reference: C. von Bar et al* (eds), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (Outline Edition)* (Munich, Germany: Sellier, 2009) bk III, 1:103.

<sup>4</sup> R.M. Goode, *Commercial Law* (Harmondsworth: Penguin Books, rev edn, 1985) 117. This criticism has been retained in E. McKendrick, *Goode on Commercial Law* (London: Penguin Books, 4th edn, 2010) 125. See also n 42 below.

United fragrances’.<sup>5</sup> A warm business relationship cooled largely because ITC repeatedly failed to supply merchandise as agreed, so that YSL itself repeatedly made commitments to retailers that it could not meet, and because ITC’s explanations of its failures and assurances of improved performance justifiably came to be regarded as implausible or outright false.<sup>6</sup> YSL eventually terminated the agreement, and sued for breach of contract or, in the alternative, misrepresentation.

At the hearing, the only two witnesses of fact were the ‘controllers’ of the companies, who had written the contract without benefit of legal advice, and personally conducted the business relationship, Mr Sunil Tuli of YSL and Mr Roy Presswell of ITC. Whilst Mr Tuli was a credible witness, Mr Presswell was quite the other thing, and Leggatt J was unable ‘to attach any credence to his testimony’.<sup>7</sup> Proof of fraud is, of course, not necessary for proof of breach. It is also settled law<sup>8</sup> that fraud is and should be difficult to prove in relationship to misrepresentation, and YSL did not base its misrepresentation claim on fraud but on the catch-all of the Misrepresentation Act 1967 s 2(1). Leggatt J did not find Mr Presswell to have been deceitful, even when his testimony about his conduct was blatantly contradicted by documentary evidence and when there may have been a strong motive for deceit. Rather he found him to be possessed of ‘a striking ability to treat wishful thinking as fact’.<sup>9</sup>

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<sup>5</sup> para [14].

<sup>6</sup> I will not discuss the actual pricing of the products, though Mr Tuli’s ‘belief that Mr Presswell had lied to him on this commercially important issue was a breaking point in the relationship’: para [73].

<sup>7</sup> para [9].

<sup>8</sup> Going back at least to *Derry v Peek* (1889) 14 App Cas 337 (HL).

<sup>9</sup> para [16].

Though we shall return to this finding,<sup>10</sup> one example of Mr Presswell's conduct will convey the merits of the dispute. At the very outset, Mr Presswell claimed that ITC had 'recently signed' the licence 'to manufacture and sell Manchester United fragrances'. But ITC was then merely in negotiation over this licence, which was granted, and then only in part, on 5 May,<sup>11</sup> ie almost 4 months after the start of the negotiations and only a week before the agreement with YSL, Leggatt J concluded that Mr Presswell 'undoubtedly' made 'a false statement' about this crucial issue.<sup>12</sup> But Mr Presswell would not, even under cross-examination by counsel armed with conclusive documentary evidence, admit this, and Leggatt J regarded this as 'symptomatic' of Mr Presswell's powers of self-deception.<sup>13</sup>

Leggatt J found that ITC seriously breached its obligations to supply certain merchandise, and that some of Mr Presswell's communications as the relationship deteriorated amounted to a repudiation allowing YSL to terminate. Fullest consideration was given to the damages consequent upon this finding, and the parties were invited to agree quantum.

This judgment has attracted such attention because of the way Leggatt J dealt with YSL's pleading that ITC breached an 'implied term ... that the parties would deal with each other in good faith'.<sup>14</sup> Before turning to this, however, it is necessary to consider a subsidiary but vital part of Leggatt J's judgment: his belief that *Yam Seng* involved a relational contract.

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<sup>10</sup> See the text accompanying n 91 below.

<sup>11</sup> para [27].

<sup>12</sup> para [16].

<sup>13</sup> para [17].

<sup>14</sup> para [119].

## YAM SENG AS A RELATIONAL CONTRACT

Leggatt J described the parties' agreement as 'a distributorship agreement which required the parties to communicate effectively and co-operate with each other in its performance',<sup>15</sup> and as such regarded it as a 'relational' contract:

English law has traditionally drawn a sharp distinction between certain relationships – such as partnership, trusteeship and other fiduciary relationships – on the one hand, in which the parties owe onerous obligations of disclosure to each other, and other contractual relationships in which no duty of disclosure is supposed to operate. Arguably at least, that dichotomy is too simplistic. While it seems unlikely that any duty to disclose information in performance of the contract would be implied where the contract involves a simple exchange, many contracts do not fit this model and involve a longer term relationship between the parties which they make a substantial commitment. Such “relational” contracts, as they are sometimes called, may require a high degree of communication, co-operation and predictable performance based on mutual trust and confidence and involve 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. Examples of such relational contracts might include some joint venture agreements, franchise agreements and long term distributorship agreements.<sup>16</sup>

This recognition of relational contracts is, of course, at complete variance with *Baird Textile Holdings plc v Marks and Spencer plc*,<sup>17</sup> which expressed the position authoritatively set out by Professor McKendrick that 'English law would not be

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<sup>15</sup> para [143].

<sup>16</sup> para [142].

<sup>17</sup> [2001] EWCA Civ 274, [2002] 1 All ER (Comm) 737 (CA) at para [16] per Sir Andrew Morritt VC. See also *Total Gas Marketing Ltd v Arco British Ltd* [1998] 2 Lloyd's Rep 209 (HL) at 218 per Lord Steyn.

How *Baird* should have been handled in light of the relational theory has been the subject of a number of interesting papers: S. Mouzas and D. Ford, 'Managing Relationships in Showery Weather: The Role of Umbrella Agreements' (2006) 59 *Journal of Business Research* 1248; L. Mulcahy and C. Andrews, '*Baird Textile Holdings v Marks and Spencer plc*' in R. Hunter *et al* (eds), *Feminist Judgments* (Oxford: Hart Publishing, 2010) and J. Morgan, 'In Defence of *Baird Textiles*' in D. Campbell *et al* (eds), *Changing Concepts of Contract* (Basingstoke: Palgrave Macmillan, 2013). See also C. Mitchell, 'Narrativising Contract Law' (2009) 29 *Legal Studies* 19.

justified in taking the step of recognising the existence of a formal category of relational contracts'.<sup>18</sup>

But, with respect, that this step should be taken is so obvious that the failure to do so is the principal cause of discontent in the current teaching of contract, where this failure is recognised by the better students as they struggle with *Williams v Roffey Bros and Nicholls (Contractors) Ltd.*<sup>19</sup> Why was the additional payment to the subcontractor enforceable, and how can this case be distinguished from *Stilk v Myrick*?<sup>20</sup> Surely the claimant seaman's performance conveyed as much 'practical benefit' to the captain as did the subcontractor's to the contractor. Regarding some practical benefits as insufficient is the point of the doctrine of existing obligations. As the better students comprehend, and as other students viscerally feel, these cases cannot logically be distinguished on the ground of practical benefit. And if practical benefit is logical nonsense, then so equally<sup>21</sup> is promissory estoppel, regardless of whether it is confined as it was intended it should be in *Central London Property Trust Ltd v High Trees House Ltd*,<sup>22</sup> or whether it is an alternative general form of liability.<sup>23</sup>

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<sup>18</sup> E. McKendrick, 'Long-term Contracts in English Law' in J. Beatson and D. Friedmann (eds), *Good Faith and Fault in English Law* (Oxford: Clarendon Press, 1995) 323.

<sup>19</sup> [1991] 1 QB 1 (CA).

<sup>20</sup> (1809) 170 ER 1168. This is Campbell's report of the case. Espinasse's report, (1809) 170 ER 851, notoriously does not bring out the relationship of policy to the consideration argument at all.

<sup>21</sup> 'Equally' is not strong enough in light of the Court of Appeal's categorical refusal in *Re Selectmove Ltd* [1995] 1 All ER 315 (CA) at 479H to recognise the 'beneficial' nature of accord and satisfaction spelt out in terms by Lord Blackburn in *Foakes v Beer* itself: (1884) 9 App Cas 605 (HL) at 622. This refusal was dictated by precedent if *Foakes v Beer* was to continue to have 'any application': *Selectmove*, *loc cit*, 481B.

<sup>22</sup> [1947] KB 130.

<sup>23</sup> *Baird Textiles*, n 17 above, paras [32]–[40], [49]–[55], [78]–[98] confirmed the shield not a sword aspect of the English doctrine of estoppel, though Judge LJ disapproved of this 'misleading aphorism' (*ibid*, para [52]), and the court (*ibid*, para

The only ground on which *Stilk v Myrick* and *Williams v Roffey* can be coherently distinguished is that they were contracts of two different types calling for different treatments. Though the seamen's obligation had an important element of flexibility derived from what would now be called the implied term of mutual trust and confidence in an employment contract, that obligation could be fixed within a reasonable compass at the time of the agreement, and it was very important that it should remain fixed over the course of performance. The essence of the agreement was that the seamen had to adjust their performance to accommodate the risks of the voyage.

The subcontractor's obligation could not be fixed in this way. Despite the criticisms that can be made of the claimant in *Williams v Roffey*, it is remarkable that the defendant took its case so far as the Court of Appeal. This not only involved a general challenge to the central feature of construction contracts of any complexity, which is that they do not agree price but leave an estimate open to modification. It also involved a particular challenge to the consequent accepted wisdom of construction contract practice that 'a main contractor who agrees too low a price with a subcontractor is acting contrary to his own interests. He will never get the job finished without paying more money'.<sup>24</sup> It certainly is the case that this essential construction law aspect of the 'factual matrix'<sup>25</sup> which influenced the court's finding about 'the true intention of the parties'<sup>26</sup> is not adequately discussed, but that the finding about consideration was tailored to reflect that true intention rather than the

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[98]) held open the possibility of adopting something like the Australian position under *Waltons Stores (Interstate) v Maher* (1988) 164 CLR 387 (HCA).

<sup>24</sup> *Williams v Roffey*, n 17 above, 10G. The judgment of Mr R Jackson QC in the Country Court which Glidewell LJ quotes at this point is extremely insightful.

<sup>25</sup> *ibid*, 19F.

<sup>26</sup> *ibid*, 18H.

intention actually being subject to the requirement of consideration is unarguable outside the courtroom.

In his influential 1997 paper on reasonable expectations, Lord Steyn told us that in *Williams v Roffey*: '[t]he reasonable expectations of the parties prevailed over technical and conceptualistic reasoning' because '[t]he court was obviously concerned that the doctrine of consideration should not restrict the ability of commercial contractors to make periodic consensual modifications, and even one-sided modifications, as the work under a construction contract proceeded'.<sup>27</sup> But Lord Steyn was unable to tell us why such expectations of modification were reasonable in that case but not in most others. The problem is that the doctrine of existing obligations cannot draw the necessary distinction. In *Stilk v Myrick*, the finding of insufficiency gave effect to the policy of limiting seamen's power to force a renegotiation of their wages, and enforcing a limit of this sort is exactly what the doctrine of existing obligations rightly does. But it does so indiscriminately, and, whilst this is correct for the majority of situations, it is wholly inappropriate to situations, such as part payment of debt in full satisfaction as in *High Trees* or flexible pricing as in *Williams v Roffey*, which turn on the legitimate modification of an existing obligation. A treatment of the doctrine of existing obligations which can make some sense of these perfectly common contractual situations, even to the tortured undergraduate,<sup>28</sup> is emerging in this country.<sup>29</sup> But no true coherence will be achieved until we are able to

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<sup>27</sup> J. Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *Law Quarterly Review* 433, 437-8. On the issues of concern to us here see J. Steyn, 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair Shirt Philosophy' [1991] *Denning Law Journal* 131.

<sup>28</sup> R. Halson, *Contract Law* (Harlow: Pearson, 2nd edn, 2013) ch 12.

<sup>29</sup> R. Halson, 'Sailors, Sub-contractors and Consideration' (1990) 106 *Law Quarterly Review* 183 and R. Halson, 'Opportunism, Economic Duress and Contractual Modifications' (1991) 107 *Law Quarterly Review* 649.



distinguish in a principled fashion between contracts the terms of which can be fixed at the time of agreement and contracts the terms of which cannot be fixed in this way.

The necessary distinction is the basis of what in most of his work the late Ian Macneil called the ‘relational’ contract.<sup>30</sup> In a relatively simple contract, the sort Macneil typically called a discrete contract, exemplified for him by a spot cash sale of a bulk generic good,<sup>31</sup> risks are allocated between the parties by ‘presentation’.<sup>32</sup> It would seem that this ugly term, which has never caught on, has handicapped the understanding of this part of Macneil’s thinking, which is the basis of the meaning of the relational contract in the sense I am now using the term. Presentation is the technique of identifying risks of non-performance and allocating them to the parties at the time of the agreement. In a discrete contract, the great majority of risks may be regarded as having been present in the minds of the parties at that time.<sup>33</sup>

In contrast, in a relational contract, exemplified for Macneil by a complex, long-term contract to supply coal to a smelter,<sup>34</sup> presentation is of limited use. The presence of large transaction costs, such as the costs of gathering information about risks that will markedly shift over the term of the contract, means that the parties must negotiate with highly bounded rationality. They cannot, therefore, agree what to do about those risks at the time of agreement, and so may have to leave essentially open

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<sup>30</sup> I have edited a collection of Macneil’s works which I believe is the most convenient point of access to those works: I.R. Macneil, *The Relational Theory of Contract* (London: Sweet and Maxwell, 2001).

<sup>31</sup> I.R. Macneil. ‘Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a “Rich Classificatory Apparatus”’ (1981) 78 *Northwestern University Law Review* 1018, 1025-6.

<sup>32</sup> I.R. Macneil, ‘Restatement (Second) of Contracts and Presentation’ (1974) 60 *Virginia Law Review* 586.

<sup>33</sup> In *Stilk v Myrick*, Lord Ellenburgh maintained that the seamen had ‘undertaken to do all that they could under all the emergencies of the voyage’ *[b]efore* they sailed from London’: *Stilk v Myrick*, n 20 above, 1161, emphasis added.

<sup>34</sup> Macneil, n 31 above, 1025-6.

even terms which constitute the core of the contract. Such an agreement should be enforced, but so also should legitimate modifications of it, and the test of legitimacy is whether the modification is of a risk which could or could not be presentiated.<sup>35</sup>

Macneil has provided an exhaustive analysis of the ‘contract planning’ which places all such provisions for flexibility within a single, theoretically coherent framework.<sup>36</sup> It is not a doctrinally coherent framework, for the positive law of contract based on the doctrine of existing obligations does not properly understand the issues and does not allow of such coherence. Macneil looked forward to the relational theory eliminating the ‘unnecessarily abrasive manner’ in which the classical law rubbed ‘against the realities of coexistence with relational needs for flexibility and change’ because that law was ‘founded on the assumption that all of a contractual relation is founded in some original assent to it, where that assumption manifestly is false’.<sup>37</sup>

In my opinion, *Yam Seng* involved a significantly, but not pronouncedly, relational contract. Only two of ITC’s obligations were pronouncedly relational in the sense I have so far used the term. ITC had an obligation to supply merchandise in quantities YSL required,<sup>38</sup> and the agreement envisaged an extension, which was

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<sup>35</sup> I have tried to show the limitations of the concept of ‘foreseeability’, as opposed to presentiation, in framing this test in D. Campbell, ‘The Law of *Force Majeure* and the Planning of Long-term Contracts’ in K. Dharmananga and L. Firios (eds), *Long-term Contracts* (Annandale, Australia: Federation Press, 2013).

<sup>36</sup> I.R. Macneil, ‘A Primer of Contract Planning’ (1975) 48 *Southern California Law Review* 627. This paper forms the framework for the second part of Macneil’s second casebook: I.R. Macneil, *Contracts: Exchange Transactions and Relations* (New York, NY: Foundation Press, 3rd edn, 2001) pt 2.

<sup>37</sup> I.R. Macneil, ‘Contracts: Adjustment of Long-term Economic Relations Under Classical, Neo-classical and Relational Contract Law’ (1978) 72 *Northwestern University Law Review* 854, 888.

<sup>38</sup> paras [95]-[99].

granted, subject to YSL achieving ‘mutually agreed targets’.<sup>39</sup> But although, for example, the precise quantities in *Yam Seng* could not be specified in advance, provision for this would have been a relatively simple matter had ITC not misrepresented its position and undertaken obligations it could not perform. Quantities of this sort have been fixed in a workable, if certainly ultimately unsatisfactory,<sup>40</sup> fashion by the implication of ‘reasonable efforts’ clauses,<sup>41</sup> for their parameters may be said to be assumed at the time of agreement, as, in essence, they were in *Yam Seng*.

But that the relational quality of the *Yam Seng* contract is not pronounced does not detract from, indeed it enhances, the real importance of Leggatt J’s identification of it as relational, which is that that it allows us to grasp the ‘relational’ quality of all contracts, and to this I now turn.

## GOOD FAITH AND RELATIONAL CONTRACTS

Leggatt J begins his discussion of YSL’s pleading on good faith by quoting Professor McKendrick to describe in very familiar terms a “‘traditional English hostility” towards a doctrine of good faith’, and by identifying three reasons for this hostility.<sup>42</sup>

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<sup>39</sup> para [26].

<sup>40</sup> Macneil thought the modern American law represented by R2d Contracts, which he called the ‘neo-classical’ law (*ibid*), was composed of such *ad hoc* responses to the failings of the classical law: Macneil, n 32 above. *Williams v Roffey* is of precisely this nature.

<sup>41</sup> I take this terminology from the judgment of Cardozo J in *Wood v Lucy, Lady Duff-Gordon* 222 NY 88; 118 NE 214 (1917). The relational nature of the development of this device in the English law is acutely set out in J. Adams and R. Brownsword, *Key Issues in Contract* (London: Butterworths, 1995) 80-7.

<sup>42</sup> para [123], quoting E. McKendrick, *Contract Law* (Basingstoke: Palgrave Macmillan, 9th edn, 2011) 221-2 (now 10th edn, 2013, 219). For McKendrick’s views on good faith see E. McKendrick, ‘Good Faith: A Matter of Principle?’ in A.D.M. Forte (ed), *Good Faith in Contract and Property Law* (Oxford: Hart, 1999). His views on *Yam Seng* are presented in ‘Good Faith in the Performance of a Contract’, in L.

In the order in which I will discuss these reasons they are: first, inconsistency with the parties' self-interest; secondly, inconsistency with the English preference for piecemeal solutions; and thirdly, inconsistency with the English preference for contractual certainty.

### **Inconsistency with the parties' self-interest**

Leggatt J rightly observes that 'English law is said to embody an ethos of individualism, whereby the parties are free to pursue their own self-interest not only in negotiating but also in performing contracts provided they do not act in breach of the terms of the contract',<sup>43</sup> and, citing the principal modern articulation of this belief, that of Lord Ackner in *Walford v Miles*,<sup>44</sup> that a doctrine of good faith is widely believed to be inconsistent with this. There is, of course, a limit to how far Leggatt J can contradict views handed down in the House of Lords, and he purports to distinguish *Yam Seng* from *Walford v Miles*. But for the purposes of assessing the theoretical significance of his judgment it is best to just say that he shows Lord Ackner's belief to be quite wrong. Leggatt J describes the actual position in a way which merits quotation in full:

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. The breadth of the relevant background and the fact that it has no conceptual limits have also been stressed ... Importantly for present purposes, the relevant background against which contracts are made includes not only matters of fact known to the parties but also shared values and norms of behaviour. Some of these are norms that command general social acceptance; others may be specific to a particular trade or commercial activity; others may be more specific still, arising from features of the

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DiMatteo and M. Hogg (eds), *Transatlantic Perspectives on Commercial Contract Law* (Oxford: Oxford University Press, forthcoming).

<sup>43</sup> para [123].

<sup>44</sup> [1992] 2 AC 128 (HL) at 138E-G.

particular contractual relationship. Many such norms are naturally taken for granted by the parties when making any contract without being spelt out in the document recording their agreement. A paradigm example of a general norm which underlies almost all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically upon trust ... The central idea [behind fidelity to the parties' bargain] is that contracts can never be complete in the sense of expressly providing for every event that may happen. To apply a contract to circumstances not specifically provided for, the language must accordingly be given a reasonable construction which promotes the values and purposes expressed or implicit in the contract.<sup>45</sup>

Leggatt J has here captured what Macneil fundamentally wanted to argue in the relational theory of contract: all contracts are relational in the sense that no contract is the product only of the agreement of the parties but rather is a fundamentally co-operative exchange relationship, the essential nature of which is not traceable to the parties' individual subjective wills. Contracting can take place only within a framework of implicit duties of respect for each party's autonomy which institutionalises that co-operation.

The view of contracting stated by Lord Ackner is the (neo-classical economic and) classical legal view of contracting parties motivated by self-interest exercised within minimal legal bounds. This view is often criticised for denying the necessity of any legal regulation of economic action at all. But it is more accurate to say that its characteristic shortcoming is that it conceives of the role of the state in a crudely rudimentary fashion;<sup>46</sup> the mere prevention of 'force or fraud' as Mill said of *laissez faire*.<sup>47</sup> This barely begins to describe the range and complexity of the legal rules, principally of the common law of contract, necessary for agreement to take place.

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<sup>45</sup> paras [133]-[135], [139].

<sup>46</sup> D. Campbell and M. Klaes, 'The Principle of Institutional Direction: Coase's Regulatory Critique of Intervention' (2005) 29 *Cambridge Journal of Economics* 263, 278-9.

<sup>47</sup> J.S. Mill, *Principles of Political Economy*, in J.S. Mill, *Collected Works*, vols 2-3 (Toronto, Canada: University of Toronto Press, 1965) 936.

Elaborating on ‘the two traditional criteria used to identify terms implied in fact ... that the term is so obvious that it goes without saying and that the term is necessary to give business efficacy to the contract’,<sup>48</sup> Leggatt J identifies a number of duties which he thinks are implicit in ‘good faith’.<sup>49</sup> These include ‘honesty’,<sup>50</sup> avoiding ‘commercial impropriety’, ‘unacceptability’ and ‘unconscionability’,<sup>51</sup> ‘fidelity to the parties’ bargain’,<sup>52</sup> ‘co-operation’, a duty not to frustrate ‘reasonable expectations’, a duty not to act ‘arbitrarily, capriciously or unreasonably’, a duty not ‘unreasonably’ to withhold a contractually required consent, a duty to bring ‘an unusual or onerous’ term ‘fairly’ to the notice of the other party,<sup>53</sup> and ‘fair dealing’.<sup>54</sup> Leaving aside interventionist statute, the (sometimes codified) common law of contract is a set of such duties, and when a purely self-interested party fails to respect them, the law of contract should not support its opportunistic attitude.

The law of contract establishes channels through which self-interest can legitimately be pursued through economic exchange. This channelling is poorly understood, but in economics it is widely referred to as the preservation of trust,<sup>55</sup> and, though it certainly remains the case that the classical law of contract gives only halting and incoherent doctrinal expression to it, it is legally institutionalised in, *inter alia*, the duties that Leggatt J sets out. The relational theory enjoys a coherence

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<sup>48</sup> para [132].

<sup>49</sup> paras [144], [150].

<sup>50</sup> paras [135]-[137].

<sup>51</sup> para [138].

<sup>52</sup> para [139].

<sup>53</sup> All para [145].

<sup>54</sup> para [150].

<sup>55</sup> D. Campbell, ‘The Relational Constitution of Contract and the Limits of “Economics:” Kenneth Arrow on the Social Background of Markets’, in S. Deakin and J. Michie (eds), *Contracts, Co-operation and Competition: Studies in Economics, Management and Law* (Oxford: Oxford University Press, 1997).

superior to the classical law because it has these duties at its core.<sup>56</sup> But it is just this quality that seems to have inhibited the reception of that theory.<sup>57</sup> Because it has focused on the norms essential to contract, the relational theory is generally regarded as paternalistic and opposed to freedom of contract, having little place for competition, and so of limited or no application.<sup>58</sup> But this certainly was not Macneil's intention,<sup>59</sup> and the relational theory can readily be restated in such a way as to give competition a central place in it.<sup>60</sup>

It seems that Macneil made a serious mistake when initially setting out the relational theory. He then used 'relational' to describe both non-presentiated contracts, ie relational as opposed to discrete contracts; and also to describe the relational element of all contracts, including discrete contracts. He never properly came to terms with the complications caused by this unfortunate usage, though in later

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<sup>56</sup> I.R. Macneil, 'Values in Contract: Internal and External' (1983) 78 *Northwestern University Law Review* 340. Macneil's taxonomies of contractual norms, of which this was but the last full statement, are excessively detailed, and R. Austen-Baker, 'Comprehensive Contract Theory: A Four Norm Model of Contractual Relations' (2009) 25 *Journal of Contract Law* 216 provides helpful suggestions for their simplification.

<sup>57</sup> Judging from the comment on *Yam Seng* by practising commercial lawyers which has so far appeared since this note was accepted for publication, this point will continue to do so despite the discussion of the relational contract the case has stimulated: H. Pugh, 'An Implied Term of Good Faith: A Watershed or a Damp Squib' (2013) 28 *Butterworths Journal of International Banking and Financial Law* 347, 348 col 3.

<sup>58</sup> eg G. Teubner, 'Contracting Worlds: The Many Autonomies of Private Law' (2000) 9 *Social and Legal Studies* 399, 404-5. See in criticism D. Campbell, 'The Limits of Concept Formation in Legal Science' (2000) 9 *Social and Legal Studies* 439, 445.

<sup>59</sup> D. Campbell, 'Ian Macneil and the Relational Theory of Contract' in Macneil, n 30 above, 20-7.

<sup>60</sup> D. Campbell, 'The Relational Constitution of the Discrete Contract' in D. Campbell and P. Vincent-Jones (eds), *Contract and Economic Organisation* (Aldershot: Dartmouth Publishing, 1996); D. Campbell, 'The Relational Constitution of Remedy: Co-operation as the Implicit Second Principle of Remedies for Breach of Contract' (2005) 11 *Texas Wesleyan Law Review* 455 and D. Campbell, 'A Relational Critique

work he did adopt the term ‘intertwined’ to describe what I think it more natural to call ‘complex’ contracts, leaving the term relational to do the fundamental work of describing the relational quality of all contracts.<sup>61</sup> This terminological clarification, distinguishing the complex quality of some contracts from the relational quality of all contracts, allows us to grasp an unappreciated aspect of the relational theory’s conception of the intentions of the parties which it is a great virtue of Leggatt J’s judgment to have effectively sought to express; the intrinsic morality of the objective conception of intention.

*Good faith, objectivity and the contractual relation*

Leggatt J’s conception of good faith seems to be heavily indebted to Lord Steyn’s article on reasonable expectations which I have mentioned, which is cited.<sup>62</sup> In particular, both Lord Steyn and he claim that it is the objectivity of the contractually recognised intentions of the parties that principally inserts good faith (and reasonable expectations) into the interpretation of those intentions:

[T]he test of good faith is objective in the sense that it depends not on either party’s perception of whether particular conduct is improper but on whether in the particular context the conduct would be regarded as commercially unacceptable by reasonable and honest people ... This follows from the fact that the content of the duty of good faith is established by a process of construction which in English law is based on

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of the Restatement (Third) of Restitution § 39’ (2011) 68 *Washington and Lee Law Review* 1063.

<sup>61</sup> I.R. Macneil, ‘Relational Contract Theory as Sociology: A Reply to Professors Lindenberg and de Vos’ (1987) 143 *Journal of Institutional and Theoretical Economics* 272, 276. Macneil’s principal statements of the relational theory after the changes he made to it are I.R. Macneil, ‘Relational Contract Theory: Challenges and Queries’ (2000) 94 *Northwestern University Law Review* 877 and I.R. Macneil, ‘Reflections on Relational Contract Theory after a Neo-classical Seminar’ in D. Campbell *et al* (eds), *Implicit Dimensions of Contract* (Oxford: Hart, 2003).

<sup>62</sup> para [145]. One of Lord Steyn’s important judgments turning on reasonable expectations is also mentioned: *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] 2 Lloyd’s Rep 194 (CA).



an objective principle. The court is concerned not with the subjective intentions of the parties but with their presumed intention, which is ascertained by attributing to them the purposes and values which reasonable people in their situation would have had ... Understood in the way I have described ... an implied duty of good faith ... is consistent with the theme identified by Lord Steyn as running through our law of contract that reasonable expectations must be protected ... such a concept is, I believe, already reflected in several lines of authority that are well established.<sup>63</sup>

Good faith is part of the objective intentions of the parties because, as we have seen, legitimate contracts never allow of untrammelled self-interest. Contracts are never the result of the agreement of two parties but are always the result of that agreement mediated by the state, which authoritatively interprets the agreement according to the understandings of a reasonable third party. It is not merely that it is impossible for parties to reveal their purely subjective intentions when contracting, though this is the case.<sup>64</sup> It is that an attempt to do so is irrelevant.<sup>65</sup> To constitute a contract, subjective intentions must, as a moral duty, be expressed in the objective form recognised as legitimate by the state, and contracting parties must negotiate accordingly if they wish to get what they want from the contract.

The essence of that objective form is that only one type of inducement to enter into an agreement is legitimate: persuasion of the other party, whose autonomy has to be respected, by showing that the agreement is a bargain which is in that party's own

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<sup>63</sup> paras [144]- [145].

<sup>64</sup> D. Campbell, 'The Relational Constitution of Contractual Agreement' in P. Heugens *et al* (eds), *The Social Institutions of Capitalism* (Cheltenham: Edward Elgar, 2003) and D. Campbell and H. Collins, 'Discovering the Implicit Dimensions of Contracts' in Campbell *et al* (eds), n 61 above.

<sup>65</sup> H. Collins, 'Objectivity and Committed Contextualism in Interpretation' in S. Worthington (ed), *Commercial Law and Commercial Practice* (Oxford: Hart, 2003) 189-90.

interest.<sup>66</sup> This can never be done by fraud, sharp dealing, or failure to satisfy myriad inevitably unstated reasonable expectations about the nature of the performances to be exchanged. To legitimately pursue its own self-interest, a party must secure the voluntary co-operation, in the form appropriate to the particular contract, of the other party. The fundamental unit for the analysis of contract therefore is not the subjective will of the contracting party, but the subjective will in the objective form of the persuasion of the other party; that is to say, in a form constitutive of the contractual relation of co-operation.

The lingering presence of the classical law in cases like *Walford v Miles* attests to a continuing failure to acknowledge the relational nature of contract.<sup>67</sup> As the classical law understands the legal framework necessary for exchange only as a set of limits which contract imposes on otherwise untrammelled self-interest, this framework seems to be opposed to freedom of contract. But it should be understood as the creation of the possibility of that freedom, for that possibility does not inhere in the subjective self-interested will but in that will in the form of the objective relation of co-operation. Parties cannot make contracts if they are really purely self-interested. Their self-interest must be channelled if contracting is to be possible at all.

In a most penetrative passage, Leggatt J tells us that:

as the basis of the duty of good faith is the presumed intention of the parties and meaning of their contract, its recognition is not an illegitimate restriction on the freedom of the parties to pursue their own interests. The essence of contracting is that the parties bind themselves in order to co-operate to their mutual benefit. The obligations which they undertake

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<sup>66</sup> D. Campbell and J. Loughrey, 'The Regulation of Self-interest in Financial Markets', in J O'Brien and G Gilligan, eds, *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford: Hart, 2013) 84-9.

<sup>67</sup> After this note was accepted for publication, a renewed defence of *Walford v Miles* on basically classical, and therefore in my opinion ultimately unavailing, lines appeared: H. Hoskins, 'Contractual Obligations to Negotiate in Good Faith: Faithfulness to the Agreed Common Purpose' (2014) 130 *Law Quarterly Review* 131.

include those which are implicit in their agreement as well as those which they have made explicit.<sup>68</sup>

Though not entirely without precedent, this passage represents an important stage in the emergence within the English law of the realisation that contract is a system of co-operation which Macneil has urged upon us:

We ... think of economic exchange as being extremely individualistic and selfish, rather than co-operative [but it] is the fact that exchange represents a species of human co-operation ... exchange involves a *mutual* goal of the parties, namely the reciprocal transfer of values. And this is true however strongly the 'economic man' - the 'as-much-as-possible-for-as-little-as-possible-in-return-man' - may dominate the motivations of both parties to an exchange.<sup>69</sup>

Macneil has also told us that remedying our lack of understanding of contractual co-operation was necessary for us properly to explain the puzzling ubiquity of the 'limits' on what was supposed to be a system of self-interest. These limits:

appear as exceptions to some general rule permitting the parties fully to define their legal status [but] if the role of the law in creating contracts were more completely presented this distortion would not occur, and these matters would be seen not as exceptions to freedom of contract but as simply part of the law's definition of contract.<sup>70</sup>

Macneil made this observation more than 50 years ago.<sup>71</sup>

### **Inconsistency with the English preference for piecemeal solutions**

On the basis of his identification of a considerable number of specific duties linked to good faith already recognised in the English law, Leggatt J suggests that 'the traditional English hostility to a doctrine of good faith ... to the extent it still persists,

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<sup>68</sup> para [148].

<sup>69</sup> I.R. Macneil, 'Whither Contracts?' (1969) 21 *Journal of Legal Education* 403, 405.

<sup>70</sup> I.R. Macneil, 'Review of H. Shepherd and B.D. Sher, *Law in Society: An Introduction to Freedom of Contract*' (1960) 46 *Cornell Law Quarterly* 176, 177.

<sup>71</sup> Over the last twenty years I have myself applied Macneil's thinking to the analysis of the relational nature of objectivity and the relational duties implicit in agreement:

is misplaced'.<sup>72</sup> Two distinct points should be distinguished here. First, to repeat, English law, despite so much that is said, has a doctrine of good faith, and there is no point arguing about it because it is analytically essential to the concept of a voluntarily agreed bargain.<sup>73</sup> But, secondly, the English doctrine is not a general doctrine of good faith but a doctrine made up of numerous specific duties. What is missing from the current English law is a clear understanding of what the law actually is, for our understanding of agreement remains dominated by the inadequate conceptions of self-interest in the classical law expressed by Lord Ackner. But as Leggatt J is aware that 'there is nothing novel or foreign to English law in recognising an implied duty of good faith',<sup>74</sup> he can say that:

there seems to me to be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying ... a duty [of good faith] in any ordinary commercial contract based on the presumed intention of the parties.<sup>75</sup>

The English law does not, then, have to decide whether to have a doctrine of good faith; it has to decide how to have one. In his outstanding 1956 paper, Powell argued that adoption of a general doctrine of good faith would allow the English courts 'to give effect to their sense of the justice of the case' without having 'to resort to contortions or subterfuges'.<sup>76</sup> Leggatt J's judgment is, in effect, an argument that this is not, or is no longer, necessary. Restating in his own terms the influential *dicta*

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Campbell, n 64 above, and Campbell, 'The Relational Constitution of the Discrete Contract', n 60 above.

<sup>72</sup> para [153].

<sup>73</sup> After this note was accepted for publication, Mr Bogle pointed out that *Yam Seng* represents the extension to England and Wales of Professor MacQueen's argument about the 'undisclosed principle' of good faith in Scotland: S Bogle, 'Disclosing Good Faith in English Contract Law' (2014) 18 *Edinburgh Law Review* 141, 144-145.

<sup>74</sup> para [145].

<sup>75</sup> para [131].

<sup>76</sup> R. Powell, 'Good Faith in Contracts' [1956] *Current Legal Problems* 16, 26.

of Bingham LJ in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*,<sup>77</sup> which he quotes,<sup>78</sup> Leggatt J tells us that:

because the content of the duty [of good faith] is heavily dependent on context and is established through a process of construction of the contract, its recognition is entirely consistent with the case by case approach favoured by the common law. There is therefore no need for common lawyers to abandon their characteristic methods and adopt those of civil law systems in order to accommodate the principle.<sup>79</sup>

Current debate would be vastly improved if it were understood that allowing that the English law recognises good faith does not logically entail that it has to have a general doctrine, or principle, of good faith. The issue is one of determining the best legal institutionalisation of the doctrine, which is, in the first instance, but only in the first instance, a matter of the formulation of legal doctrine. Having seen what has happened to the law of negligence since *Donoghue v Stevenson*, I am surprised that anyone committed to the core value of the market institutionalised in contract, freedom of choice, which requires that the terms of an exchange should be endogenously determined by the parties to it, can welcome a general doctrine of good faith. It seems to me that, of its nature, such a doctrine invites exogenous determination of terms by the courts in just the way that the law of negligence now completely rests on expansive judicial policy-making. Lord Atkin was no doubt right to say that each of the traditional categories of negligence expressed the existence of a duty of care. But this does not entail that it is necessary to determine the reach of that duty by argument from the neighbour ‘principle’,<sup>80</sup> and the increasingly deplorable consequences of this *petitio principii* have, of course, been enormous.

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<sup>77</sup> [1989] 1 QB 433 (CA) at 439D-F.

<sup>78</sup> para [121].

<sup>79</sup> para [147].

<sup>80</sup> *Donoghue v Stevenson* [1932] AC 562 (HL) at 579-80. The late Professor Birks’ entire approach to the classification of the law of obligations was based on a belief

### **Inconsistency with the English preference for certainty**

Though how *Yam Seng* deals with this point will substantially determine whether its reception is positive or otherwise,<sup>81</sup> Leggatt J gives but short shrift to ‘the fear that recognising a duty of good faith would generate excessive uncertainty’ because, as ‘there is nothing unduly vague or unworkable about the concept[, its] application involves no more uncertainty than is inherent in the process of contractual interpretation’.<sup>82</sup> If we accept Leggatt J’s insertion of good faith into objective intentions, then this claim is, it is submitted, essentially sound. When ‘the basis of the duty of good faith is the presumed intention of the parties and [the] meaning of their contract’,<sup>83</sup> then such insertion ‘does not involve the court in imposing its view of what is substantively fair on the parties’.<sup>84</sup> Good faith poses no particular interpretative problem, and indeed one could say that all interpretative problems will be problems of the interpretation of good faith in the particular case.<sup>85</sup> But to say this is by no means to claim that *Yam Seng* itself resolves the problem of uncertainty in the application of good faith.

YSL sought to give ‘relevant content’ to its pleading of breach of the duty of good faith by claiming that, in the circumstances of the case, that duty resolved into

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that the identification of ‘generic conceptions’ entailed precisely this: P. Birks, *An Introduction to the Law of Restitution* (Oxford: Clarendon Press, rev edn, 1989) 17.

<sup>81</sup> A comment on the case which appeared after this note was accepted for publication makes this clear: S. Whittaker, ‘Good Faith, Implied Terms and Commercial Contracts’ (2013) 129 *Law Quarterly Review* 463.

<sup>82</sup> para [152].

<sup>83</sup> para [148].

<sup>84</sup> para [150].

<sup>85</sup> Further development of this line of argument has to be conducted in light of the difficulties of Lord Hoffmann’s treatment of implied terms in *AG of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988.

two specific implied duties.<sup>86</sup> The most important of these for our purposes was ‘a duty not to give false information’, which Leggatt J agreed could be derived from the wider implied duties, particularly ‘the core expectation of honesty’,<sup>87</sup> and, indeed, he described this specific obligation as ‘the implied duty of honesty in the provision of information’.<sup>88</sup>

But there are two senses in which ITC could have had a duty not to give false information. One is the general prohibition of fraud which Leggatt J thought part of the duty of honesty implicit in all contracts. However, we have seen that Leggatt J did not maintain that Mr Presswell was dishonest in the sense that he had an intention to deceive. But not condemning Mr Presswell as dishonest in this way gives rise to a serious difficulty.

For the second sense in which ITC could have had a duty not to give false information is that it had a contractual duty to give correct information which it breached. Now, this was the case, and it is the main point Leggatt J tried to establish. But such a duty cannot be (entirely) traced to the duty of honesty implicit in all contracts because it is only in a small sub-set of contracts that the defendant has an obligation of this sort to give information. Of course, any information the defendant may choose to give cannot be false,<sup>89</sup> and Mr Presswell certainly did, right from the outset, give false information in this sense, entirely justifying ITC’s being found liable for misrepresentation. But this is not enough to be able to say that ITC had a contractual duty to give correct information. In order to maintain that ITC had and breached such a duty, Leggatt J is obliged to say, quite inconsistently with his general

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<sup>86</sup> paras [154]-[164].

<sup>87</sup> para [156].

<sup>88</sup> para [165].

<sup>89</sup> para [141].

opinion of Mr Presswell's state of mind, that Mr Presswell was 'objectively ... dishonest' when he gave false information.<sup>90</sup>

But it is, with the greatest respect, difficult to understand what is meant by objective dishonesty, which seems to be the dishonesty of one who has not been proven to be dishonest.<sup>91</sup> This may be enough for the mess that is the current law of misrepresentation, but it is not enough for an innovative attempt to base liability on a coherent handling of the implied contractual duties. The problem, of course, is that, even as Leggatt J has it, good faith is doing far too much work. He is right to conclude that *Yam Seng* was a case in which 'the requirements of honesty go further' than 'the core value of honesty'.<sup>92</sup> But, as with Lord Steyn celebrating the rights of the matter prevailing over 'technical and conceptualistic reasoning' in *Williams v Roffey*, Leggatt J is unable to tell us why it is right to go further in this particular case, but not in most others. As he is unable to identify precisely why the contract justifies finding an obligation to provide information, for the breach of which the defendant is strictly liable, even Leggatt J's conclusions have the air of an imposition of good faith as a moral standard not derived from the intentions of the parties.<sup>93</sup>

In the end, Leggatt J has to descend to using the tired device of the collateral warranty to underpin his decision about ITC's contractual liability for failure to supply merchandise as required. His claim that 'a reasonable person would have understood the parties to have intended' to use this unnatural legal fiction somewhat

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<sup>90</sup> para [171].

<sup>91</sup> This concept of objective dishonesty seems to be derived from the questionable criminal law case of *R v Ghosh* [1982] EWCA Crim 2, [1982] QB 1053.

<sup>92</sup> para [141].

<sup>93</sup> One therefore cannot but suspect that, had the judgment not, in the end, established ITC's relevant duties by very detailed analysis of its specific obligations but had merely been based on what is said of good faith, then appeal over liability in contract,



defeats the purpose of his entire judgment.<sup>94</sup> Leggatt J is driven to rely on some magic in the word ‘collateral’ because he cannot explain why duties which ‘go further’ in this case should be recognised. Evidently it is not enough, though it is a very great deal, to say that *Yam Seng* involved a relational contract. This must be tied to an understanding of presentation, and of relational obligations as responses to presentation’s limits, if, as is Leggatt J’s clear intention, we are to dispel the fear that the use of good faith he envisages invites uncertainty in the sense of interpretation which imposes exogenous standards.

Though the very completeness of Leggatt J’s review of all the terms invoking good faith to some extent inevitably invites this, I fear something has gone wrong when that review yields such an overwhelming pleonasm of (near) synonyms of good faith. And someone like myself who used to be very preoccupied with modern social theory can readily recognise what it is. Pleonasm is substituting for lack of comprehension. Leggatt J emphatically shows that untrammelled self-interest is not and cannot be the basis of the English law of contract, but, in the absence of an adequate understanding of presentation and its limitations, he cannot entirely satisfactorily handle the difference between relational as opposed to discrete contracts. The result in *Yam Seng* is an ultimately unanchored set of duties which invites the uncertainty which it is Leggatt J’s wish to avoid.

### **CONCLUSION: THE VALUES OF GOOD FAITH**

Like, I fear, the overwhelming majority of English lawyers and academics now obligated to form an opinion on such matters, I do not enjoy ‘any great familiarity’

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if not in misrepresentation, might, even in this case, in which the defendant’s position had very little merit, have been invited.

with the way good faith works in continental systems,<sup>95</sup> and such knowledge as I do have is entirely founded on accounts in English of that working.<sup>96</sup> I can merely say that, despite long being convinced that the ‘traditional English hostility’ certainly is ‘misplaced’, it seems to me that a doctrine of good faith articulated through specific duties will be far more likely to respect the intentions of the parties than a general doctrine. But, despite the type of approach Leggatt J shows to be possible, nothing really can be done to base a law of good faith on those intentions if the prevailing attitude towards interpretation is one of sympathy towards welfarist improvements upon them. And as much current appeal court law and much scholarship is of this nature, advocacy of a general duty is largely driven by a broad sympathy with the substitution of exogenous standards for the intentions of the parties.

Leggatt J situates his views against ‘[t]he modern case law on the construction of contracts’ exemplified by ‘the famous speech of Lord Hoffmann in *Investors*

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<sup>94</sup> para [98].

<sup>95</sup> Steyn, n 27 above, 438.

<sup>96</sup> A law of which I can claim a detailed knowledge, the US law of contract, is used by Leggatt J (para [125]), as it was by Lord Steyn, n 27 above, 438, as a positive example of the adoption of good faith in a common law jurisdiction. Without argument and with the greatest respect, I will say that this is not an entirely happy example. On the principal problem raised by *Yam Seng* see V.P. Goldberg, ‘Discretion in Long-term Open Quantity Contracts: Reining in Good Faith’ (2002) 35 *University of California Davis Law Review* 319. In a paper which he has been good enough to show me in draft, Professor Feinman has tried to restate the US doctrine of good faith in a way which avoids many of its acknowledged problems by taking essentially the line I here argue is taken by Leggatt J: J.M. Feinman, ‘Good Faith and Reasonable Expectations’

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2245144](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2245144)

Two books published last year most interestingly present to a UK readership the ‘new formalism’ that, one step ahead of the new contextualism, has been the most interesting line of development of recent US contract theory: C. Mitchell, *Contract Law and Contract Practice* (Oxford: Hart, 2013) and J. Morgan, *Contract Law Minimalism* (Cambridge: Cambridge University Press, 2013).

*Compensation Scheme Ltd v West Bromwich Building Society*'.<sup>97</sup> What is typically ignored in the effulgent encomia to what effectively is a lecture on interpretation given in this speech is that the actual interpretation Lord Hoffmann placed on the vexed term of the contract is unarguably highly contentious and, in my opinion, preposterous.<sup>98</sup> This speech has been so well received only because its solicitude for the 'purpose' of the contract had the effect of keeping afloat, in respect of a certain group of investors, a no doubt well intended but 'needlessly confusing and obscure' government scheme that was drafted in so 'slovenly' a manner as to prejudice those investors' interests.<sup>99</sup> The warning sounded in *Investors*, that '[p]urposive interpretation' 'must not be allowed to shade into' 'creative interpretation',<sup>100</sup> was most unfortunately ignored, in deed if not in some words, in the very case which has established the 'new contextualist' atmosphere for the 'modern case law' of interpretation.

To some extent, the result in *Investors* is a contractual example of the characteristic welfarist extension of latitude to the 'public' as opposed to the 'private'. But the essential concern with a purpose which the court itself must supply because, *ex hypothesi*, in cases like *Investors* the favoured party has failed to identify it to the contract, evidences the willingness to apply even to commercial cases exogenous

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<sup>97</sup> para [135], citing [1998] 1 WLR 896 (HL) at 906H-918D. Leggatt J also mentions Lord Hoffmann's subsequent *dicta* in *BCCI v Ali* [2001] UKHL 8, [2002] 1 AC 251 at para [39].

<sup>98</sup> The powerful dissent by Lord Lloyd (*Investors*, n 97 above, 899-906H) affirmed the judgment of the Court of Appeal ([1998] 1 BCLC 521 (CA)), which, in my opinion, clearly identified the confusion on which the Chancery judgment turned: [1998] 1 BCLC 493 (Ch D).

<sup>99</sup> *Investors*, n 97 above, 899B per Lord Lloyd.

<sup>100</sup> *ibid.*, at 904D.

standards characteristic of a general duty of good faith.<sup>101</sup> It is in this connection that I have claimed that determining a correct policy towards good faith is only in the first instance a question of legal doctrine. Ultimately it is a question of values. The growth of welfarism may be described as an attack on the values that lie behind sanctity of contract.<sup>102</sup> There are, of course, good reasons for this attack, which is why it is being led by some of our best judges and commentators. The capacity to utilise the law to one's advantage in terms of turning one's subjective will into an objectively binding promise from another is itself a scarce and unequally distributed personal and social resource, and unequal distribution of a social resource rightly gives rise to a presumption of injustice. Courts are continually faced with a choice between giving effect to the objectively expressed intentions of the parties, or trying to produce a better outcome than this by giving effect to what they believe one of the parties really subjectively meant, although that party has failed to give that meaning an adequate objective statement. This is an essentially contested choice because the values which underpin both alternatives all have their attractions.<sup>103</sup> And, as Professor Macaulay

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<sup>101</sup> Mitchell, n 96 above, 6 says of the Supreme Court's injunction 'to uphold commercial purposes and pursue commercially reasonable outcomes over absurd ones when interpreting commercial agreements' in *Rainy Sky CA and others v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900 that 'it is not clear whether [this] appeal to commercial considerations ... entails a set of determinate and readily identifiable values that can genuinely inform legal reasoning or is just a rhetorical gloss to obscure an exercise of judicial discretion'.

<sup>102</sup> With regard to our specific concerns here see J.H. Baker, 'From Sanctity of Contract to Reasonable Expectations' (1979) 32 *Current Legal Problems* 17.

<sup>103</sup> The consequent tension is nowhere more interestingly exhibited than in Professor Brownsword's leading analysis of good faith: R. Brownsword, 'General Considerations' in M.P. Furmston (ed), *The Law of Contract* (London: Butterworths, 4th edn, 2010) paras 1.79-1.103. This comprehensive statement contains references to Brownsword's earlier work on the subject.

has acutely put it, adjudication and policy-making in contract turns on the ‘problem of proportioning’ these values.<sup>104</sup>

I believe that, in an appropriately delimited but nevertheless as large as possible market sphere, freedom of contract should be the paramount – it cannot be the sole - value which should guide us when taking a position on this issue, but that the balance struck in recent leading judgments is generally far too welfarist. However this is, in any particular case determining Macaulay’s proportion depends on identifying the nature of the particular contract. Is it a largely presentiated, discrete contract in which the parties should be left, so far as is possible given what we have seen of the illusory nature of pure self-interest, to their own efforts to give objective expression to their subjective will, and to rightly suffer the consequences of the shortcomings of those efforts? Or is it a minimally presentiated, relational contract in which the parties could, to varying degrees, reasonably rely on the active assistance of each other to realise their intentions, and can count on the court to endorse such reliance, even when it takes the form of radical modification?

When making our minds up about this, we must recall that the fact that all contracts are relational in the general sense we have discussed does not mean they all have the dominant quality of being relational in the restricted sense. A contract may be relational in the first sense but still involve highly competitive negotiating stances; or, to put it the other way around, a highly competitive contract is possible only when the parties acknowledge the mutual moral duties of their fundamentally co-operative relationship. Leggatt J’s intrinsically moral but flexible conception of good faith is an

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<sup>104</sup> S. Macaulay, ‘Justice Trayner and the Law of Contracts’ (1961) 13 *Stanford Law Review* 812, 813.

important and very welcome development of the English law's capacity to come to terms with this.