Harmonisation of Contract Law: In Search of a Solution to the Good Faith Problem

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1 The Duty of Good Faith: A Major Obstacle to Transnational Unification

1.1 A Colourful Concept Freely Chosen from the Palette?

In the Civil Code tradition, there is clear statutory ground for the existence of contractual good faith.* In many other legal orders, this is not the case. Still, in many of these countries, it is more or less well established that the parties to a contract are under a duty of good faith. This view is sometimes contested, and most often with reference to the principle of freedom of contract. The parties to the contract, it is said, are masters of the contractual regime. These conflicting views lead us to focus on the explanations of the existence as to a contractual duty of good faith which can hold water, and which ones do not.

The legal concept of good faith is sometimes viewed as a means of allowing a consideration based on morals or sentiment, rather than "true" law, into legal equations.[1] Professor Jes Bjarup has maintained that we cannot rid ethics from the operation of law.[2] I will in no way try to contest this view. Nonetheless, good faith as a legal norm *primarily* ought to be explained in another way. There are at least two good reasons for leaving the moral explanation play second fiddle. Firstly, this explanation does not give guidance where guidance is required most. Secondly, this traditional view in fact operates as an obstacle to any transnational harmonisation of contract law.

At present, there is no single explanation that is broad enough to cover all the uses of the contractual good faith norms found in the Western legal systems, and at the same time, precise enough not to cover more than necessary. However, the proposal that the duty of good faith is built on a principle of contractual proportionality ought to be seriously considered.

1.2 The War of the Worlds

Significant international efforts have been recently made as to harmonising contract law. The results of these efforts, still at the preliminary stages, are promising. The UNIDROIT Principles of Commercial Contracts (UP)[3] and the Principles of European Contract Law (PECL)[4] have received much attention as

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1 *See e.g.* Behrends, O. *Die rechtsethischen Grundlagen des Privatrechts*, in F. Bydlinski & T. Mayer-Maly (Hrsg.), Die ethischen Grundlagen des Privatrechts, Springer, Wien 1994, p. 1 ff., Summers, R. S. *The General Duty of Good Faith – Its Recognition and Conceptualization*, 67 Cornell L. Rev. p. 811 (1982), and Auer, M. *Good Faith: A Semiotic Approach* (2002) 2 E.R.P.L. p. 279.

2 *See e.g.* Bjarup, J. *Ought and Reality: Hägerström's Inaugural Lecture Re-considered*, 40 Sc. St. L. 11 (2000) p. 72.

3 UNIDROIT Principles were adopted in 1994. A new edition was published in 2004.

4 PECL Part I, covering performance, non-performance and remedies, was published in 1995. PECL Parts I and II combined was published in 2000 (O. Lando & H. Beale (eds.), *Principles of European Contract Law. Parts I and II. Combined and Revised*, Kluwer Law International,

well as positive reactions. These compilations of principles are levelling the ground for future binding transnational instruments. There are, of course, a number of more or less problematic differences within the multitude of jurisdictions to overcome, but there is probably no greater threat to successful harmonisation of contract law than the divergences concerning the principle of good faith,[5] at least as applied with respect to contract formation.

In the civil law countries of Continental Europe and South America, in the province of Quebec and the state of Louisiana, in Japan and Israel, the entirety of the contract law systems presuppose the principle of good faith, while the same principle is denied and viewed with scepticism in England and other parts of the Commonwealth.

These conflicting views as to good faith occasionally surface. At a late stage in the work on the UN Sales Convention (CISG), the proposed general duty to act in accordance with good faith and fair dealing was transformed into a principle of interpretation as to the convention itself.[6] At first, the British appeared to have won that struggle, but in the literature of the civil law countries, one can find that this downgrading of the good faith provision has been interpreted to have little importance.[7] Both UP and PECL contain provisions stating an obligation to act in accordance with good faith and fair dealing.[8] The risk is obvious that the European common lawyers would respond in a sceptical manner, relegating good faith to a lesser status, if the contents of these instruments or CISG would become binding in the United Kingdom and Ireland in the future. It therefore may seem that harmonisation is a dream that will never be realised. Nevertheless, a closer level of harmonisation ought to be possible, if the good faith concept could be demystified for the common law world.

1.3 The European Principle of Good Faith

Only five or ten years ago, most spectators in the European legal arena would have assessed the odds of creating a single Pan-European contract law to be as

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The Hague/London/Boston 2000), and covers, apart from the topics dealt with in the 1994 version, formation, authority of agents, validity, interpretation, content and effects. Part III, published in 2003, contains a wide range of subjects, namely plurality of parties, assignment of claims, substitution of debtors, set-off, prescription (*i.e.* limitation periods), illegality on grounds of public policy, mandatory rules etc., conditions, and interest on capital.

5 Lando & Beale, *ibid.*, p. xxii f.

6 Honnold, J. O. *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed. Kluwer Law International, The Hague 1999, p. 99.

7 *See e.g.* Herber, R. in P. Schlechtriem (ed.), Commentary on the UN Convention on International Sale of Goods (CISG), 2nd ed. Oxford University Press, Oxford 1998, at no. 16, Magnus, U. *Wiener UN-Kaufrecht (CISG)*, in the series J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen, Rev. ed. Sellier de Gruyter, Berlin 1999, p. 152 at no. 10, and the cases cited there, Bonell, M. J. in C. M. Bianca & M. J. Bonell, *Commentary on the International Sales Law. The 1980 Vienna Sales Convention*, Giuffrè, Milano 1987, p. 86 ff. and Jaluzot, B. *La bonne foi dans les contrats. Étude comparative de droit français, allemand et japonais*, Dalloz, Paris 2001, p. 4 f.

8 UP Art. 1.7; PECL Art. 1:201.

poor as the prospects of earlier attempts to codify English contract law. The work to unify European contract law is however is so energetically driven by different constellations of jurists in Europe, that it undoubtedly will lead to far-reaching demands of harmonisation, even if in the form of sector specific legislation of increased density rather than a comprehensive civil code.

PECL contains a number of provisions referring to good faith. Here, it is enough to mention its occurances in Article 1. The first contract principle mentioned in PECL is, not surprisingly, freedom of contract, Article 1:102. Freedom of contract can subsequently be seen as the paramount principle in PECL, but despite this is "subject to the requirements of good faith and fair dealing, and the mandatory rules established by these Principles". Article 1:2, General Duties, contains only two provisions: Article 1:201 on good faith and fair dealing and Article 1:202 on the duty of co-operation. Article 1:302 defines reasonableness as "to be judged by what persons acting in good faith ... would consider to be reasonable." Article 1:305 concerning "imputed knowledge and intention" states in subparagraph (b) that the behaviour of a person acting with a party's assent is to be imputed to the party itself. Not every kind of behaviour will be imputed, only acts that are intentional, grossly negligent or not in accordance with good faith and fair dealing.

The principle of good faith and fair dealing in PECL is held to be one of the greatest importance,[9] and is furthermore explicitly made mandatory. Although experts from all over the EU have participated in the work of this commission, the good faith rules cannot be viewed as a restatement of an existing mutual legal stance within the EU. Of course one must accept certain compromises, but the European common law countries most probably would not have accepted this compromise had the impact of PECL been greater.

Despite the fact that common lawyers participated in the drafting of PECL, good faith has been given a major role in this instrument. Perhaps good faith is not such a problematic obstacle after all? However, such a conclusion would be completely erroneous, since the formulations in PECL and its comments are cleverly put. According to PECL, good faith is nothing other than "honesty and fairness in mind".[10] This seems to be that which usually is called "honesty in fact", *i.e.* the same standard which until very recently was employed in the American "pure heart and empty head" test of Uniform Commercial Code, amended 2003. This definition must have been a relief for the British members of the commission. However, PECL pairs the good faith concept with the concept of fair dealing, *i.e.* the same expression used in many other international instruments,[11] namely "good faith and fair dealing". "Fair dealing", in its turn, is an "objective standard". It is a more comprehensible notion for the British,[12]

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9 Lando, O. *Eight Principles of European Contract Law*, in R. Cranston (ed.), Making Commercial Law. Essays in Honour of Roy Goode, Oxford University Press, Oxford 1997, p. 103 ff.

10 O. Lando & H. Beale (eds.), *supra* note 4, p. 115.

11 CISG Art 7(1). Unidroit Principles Art 1.7. UCC Art 2-103(1)(b) before the amendment of 2003 (now Art 2-103(1)(k)).

12 Compare Goode, R. M. *The Concept of "Good Faith" in English Law*, Saggi, Conferenze e Seminari, no. 2, Centro di studi ricerche di diritto comparato e straniero, Roma 1992, p. 4,

resembling reasonable trade practices. However, if PECL Art. 1:201 was intended to cover only cases of dishonesty and behaviour contrary to ordinary business practices, its application would almost be as narrow as the current standard of English law. Fair dealing, though, "means observance of fairness in fact" according to the comments of the Article,[13] so that the concept covers at least that which is generally meant by objective good faith, a great deal more than simply a referral to usage in the trade in question.

1.4 Good Faith in Common Law

The concept of good faith is familiar even in common law and seems originally to have found its way into equity through the Canon law.[14] After the formalisation of equity in England in the 17th century, the idea of a generally applicable principle of good faith weakened. In the 18th century, Lord Mansfield, "the father of English commercial law",[15] found good faith to be a "governing principle … applicable to all contracts and dealings".[16] Thus, good faith then seemed to have a safe harbour in English law, although at this time not in the field of equity, but in the law of contract.[17] Later, at the peak of the classical period of English contract law around 1870, there was a reaction against good faith.[18] However, several examples of the opposite can be found even from that time.[19] Presently, the majority view is that good faith is not a generally applicable principle in English contract law.[20]

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and Harrison, R. *Good Faith in Sales*, Oxford University Press, Oxford 1997, p. vii: "'Good faith' nowadays has a *fuzzy* sound to the ears of English lawyers. For that reason, I have often used the term 'fair dealing'." [italics in the original]

13 Lando & Beale, *supra* note 4, p. 115 f.

14 O'Connor, J. F. *Good Faith in English Law*, Dartmouth, Aldershot 1990, p. 1 ff.

15 Goode, R.M. *Commercial Law in the Next Millennium*, Hamlyn Lectures, London 1998, p. 15.

16 *Carter* v. *Boehm* (1766) 3 Burr 1905; 97 ER 1162.

17 Davis, R. J. *The Origin of the Duty of Disclosure under Insurance Law* (1991) 4 I.L.J. 71. Compare J. J. White & R. S. Summers, *Uniform Commercial Code*, 2nd ed. West, St. Paul, Minn. 1980, p. 19 f., finding that the obligation of good faith in the performance and enforcement of contracts in the American Uniform Commercial Code (UCC) Art. 1-203 "is essentially equitable in character".

18 Harrison, *supra* note 12, p. 4 ff., especially p. 7.

19 Harrison, *supra* note 12, *passim*, *inter alia* p. 103 ff.. Waddams, S. M *Pre-contractual Duties of Disclosure*, in P. Cane & J. Stapleton (eds.), Essays for Patrick Atiyah, Oxford University Press, Oxford 1991, p. 237 f.

20 *See e.g.* Whittaker, S. J. (ed.), in H. Beale (gen. ed.), *Chitty on Contracts. Vol. I*, 29nd ed. Sweet & Maxwell 2004, London, p. 17 ff. Kötz, H. *Towards a European Civil Code: The Duty of Good Faith*, in P. Cane & J. Stapleton (eds.), The Law of Obligations. Essays in Celebration of John Fleming, Oxford University Press, Oxford 1998, p. 245: "It can indeed be shown that there are a great many well-established rules of English contract law which reflect a concern for good faith, fair dealing, and the protection of reasonable expectations. But these rules, although reflecting the general object of the law to do justice and ensure fairness, do not qualify as good faith rules." The last sentence seems to be citing O'Connor, *supra* note 14, p. 32.

The unity of the common law systems regarding the treatment of good faith is disintegrating.[21] Even though most common law countries seem to deny pre-contractual good faith as a general principle,[22] there are signs, albeit mostly minor, of the opposite in Canada,[23] Scotland,[24] Australia[25] and the United States.[26] Even if the common law systems still show a somewhat unified front towards good faith in the formation of contracts, this is not the case with the later stages of the contract. Not only the United States[27] but also Canada[28] and Australia[29] seem to have accepted good faith in the performance and enforcement of a contract.

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21 The unity appeared to be intact as late as 1987, *See* Honnold, J. O. *Uniform Words and Uniform Application. The Sales Convention and International Juridical Practice*, in P. Schlechtriem (Hrsg.), Einheitliches Kaufrecht und nationales Obligationenrecht, Nomos, Baden-Baden 1987, p. 141 f., where Honnold refers to the opinions of the following national reporters, given on a conference in February 1987, not accepting a general duty of good faith in sales law: "Clarke (*U.K*) …; Sutton (*Aus.*) ...; Farrar (*[N].Z.*) …; Ziegel (*Can.* .) …".

22 *See e.g.* for England, *Walford and Other Apellants* v. *Miles and Other Respondents* [1992] 2 A.C. 128 and R. M. Goode, *supra* note 12, p. 2 ff.; for Australia, Peden, E. *Good Faith in the Performance of Contracts*, LexisNexis Butterworths, Chatswood, NSW 2003, p. 4; for Canada, *Martel Building Ltd.* v. *Canada*, 1 [2000] S.C.R. 860, where the Supreme Court of Canada held that the tort of negligence could not be extended to negotiations, and, as *obiter dictum*, that Canadian law did not recognise a duty to bargain in good faith.

23 In the Canadian case referred to *supra* note 22, *Martel Building Ltd.* v. *Canada*, 1 [2000] S.C.R. 860, the Supreme Court of Canada added: "Whether or not negotiations are to be governed by a duty of good faith is a question for another time".

24 According to Scots law "the element of good faith" for a creditor may encompass a duty of disclosure and a duty to give advice to a presumptive cautioner (surety), *Smith* v. *Bank of Scotland*, 1997 S.L.T. 1061 (H.L.), at 1068 per Lord Clyde (*See* also at 1066: "the basic element of good faith"). Compare *Clydesdale Bank plc* v. *Black* 2002 S.L.T. 764 (Ex. Div.) and *The Royal Bank of Scotland Plc* v. *Wilson*, 2003 S.L.T. 910 (2 Div.). The interest in the civil law roots of Scots law is said to be increasing, Beatson, J. *Has the Common Law a Future?* (1997) 56 Cambridge L.J. 291, fn. 1. *Smith* v. *Bank of Scotland*, seems to support a general principle of good faith in formation, since the information and advice omitted should have been given pre-contractually, although the boundaries of such a principle remain unclear. *See* MacQueen, H. *Good Faith in the Scots Law of Contract: an Indisclosed Principle?*, in A. D. M. Forte (ed.), Good Faith in Contract and Property, Hart Publishing, Oxford 1999, p. 5 ff. and, for criticism, Lord Rodger of Earlsferry, *"Say not the Struggle Naught Availeth": The Costs and Benefits of Mixed Legal Systems*, 78 Tul. L. Rev. 432 ff. (2003).

25 Agreements to negotiate in good faith may be enforceable, *Coal Cliff Colleries Pty. Ltd.* v. *Sijehama Pty. Ltd.* (1991) 24 N.S.W.L.R. 1. An obligation to renegotiate has been found in some cases, *See* Peden, *supra* note 22, p. 6 f., with references.

26 *See e.g.*. Summers, R. S *The Conceptualization of Good Faith in American Contract Law*, in R. S. Summers, Essays in Legal Theory, p. 301 f., and the references in Burton, S. J. & Andersen, E. G. *Contractual Good Faith – Formation, Performance, Breach, Enforcement*, Little, Brown and Co., Boston, New York, Toronto, London 1995, p. 331 fn. 3.

27 Burton & Andersen, *ibid.*, p. 20 ff.

28 *See e.g. Gateway Realty Ltd.* v. *Arton Holdings Ltd.* (1991) 106 N.S.R. (2d) 180 (S.C.).

29 Australian case law and literature seem to accept more and more good faith as a basic principle in performance and enforcement, *See e.g. Renard Constructions (ME) Pty. Ltd.* v. *Minister for Public Works* (1992) 26 NSWLR 234 per Priestley JA. and Willmott, L. Christensen S. & Butler, D. *Contract Law*, Law Book Co., Sidney 2001, p. 260.

The English contract law debate has shown genuine concern for the risk of having to adopt a generally applicable duty of contractual good faith.[30] The voices heard are so strong that they cannot be dismissed merely as desperate attempts by tradition-bound lawyers to guard the homogeneity of domestic contract law. Implanting good faith into the English common law of contract, it is argued, may impose a threat to its philosophical foundations and the entire case law that has cautiously been built upon those foundations.[31]

Overwhelming evidence of the impact potential of good faith can be taken from a nearby example: Since the duty of good faith in performance and execution of contracts has won general acceptance in the United States, the application of good faith has exploded in such a manner that it now reaches into nearly every corner of American contract law.[32] Furthermore, the fact that Anglo-American contract law can be described as imperialistic, *i.e.* subjugating a major part of the legal order under its regime and thus applying contract law to matters that civil and Nordic law would handle in other fields of law, only enhances the potential impact of good faith. Arguably, the scepticism displayed towards good faith by a majority of English lawyers, consequently is not an exaggeration, it is a sign of health. If a general principle of good faith is accepted in English contract law, there probably would be no way of letting it enter the contractual environment in a controlled manner.

1.5 Good Faith in Nordic Law

Why compare common law to Nordic law? There are significant differences between these legal families, but on this crucial point, good faith, there is surprisingly much in common. The lack of sufficient statutory basis for a general obligation of good faith, leave the Nordic systems much in the same state of confusion as seen in the common law. The search for a theory of good faith has just begun in Nordic law, and turning to common law might not always serve answers in a Q&A format, but common law is definitely presenting the Q's in depth.

It might be surprising for a civil or common lawyer to find that the existence of a good faith principle might be questioned in a Nordic law jurisdiction, and that the Nordic legal systems as to this particular point are remarkably heterogeneous.

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30 *C.f.* Goode, *supra* note 15, p. 19; Goode, *supra* note 12, M. G. Bridge, *Does Anglo-Canadian Law Need a Doctrine of Good Faith?*, 9 Can. Bus. L. Rev. 426 (1984).

31 Compare Teubner, G. *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, (1998) 61 MLR 11, who argues against this view but agrees that a general duty of good faith would irritate British law.

32 Since the adoption of the Uniform Commercial Code in 1952, and Restatements (Second) of Contracts in 1981, good faith in performance and enforcement has rapidly evolved into something of a cornerstone in American contract law. The number of published court cases considering good faith increased considerably from 1980, when the contents of the amended Restatements became public, Burton & Andersen, *supra* note 26, p. 21 f.

In 1915–1918, Denmark, Norway and Sweden adopted similar contract acts after a joint drafting.[33] The leading representatives from each country were all legendary legal scholars, and their writings carry great authority even today. Norway's representative, Fredrik Stang, placed a lot of trust in the ethical standards of the markets. He was clearly in favour of a general principle of good faith – even if he did not use those words – and he wanted the general clause as to invalidity in the Nordic contract acts, § 33, to also be applied in cases of negligence.[34] Others, such as Kristen Andersen, Ragnar Knoph and Kai Krüger continued in these tracks. Julius Lassen, the Danish representative, most likely did not recognise good faith as a general principle.[35] However, the other major Danish academic in contract law at that time, Henry Ussing, demonstrated early that he was in favour of good faith,[36] and his views were passed on to later generations by Bernhard Gomard and Ole Lando. The Swedish representative, Tore Almén, did not address good faith at all. His works are characterised by highly skilled technicality, and he probably thought that a general principle of good faith would either be superfluous or even perilous in its vagueness. The works of Knut Rodhe, another Swedish expert, give the same reflections,[37] and Jan Hellner – even though he wrote the Swedish draft of the new general clause against unconscionable terms, § 36[38] – did not mention a duty of loyalty, even sometimes questioning its benefits, until the early 1990's.[39]

In addition to this, the school of Scandinavian realism became influential especially in Sweden in the 1920's and the following decades.[40] The founders of this school fought fiercely against the use of ambiguous "metaphysical" concepts such as good faith.[41] In 1945, the prominent Swedish academic in contracts and torts, Professor Hjalmar Karlgren, later appointed Justice of the Supreme Court, reacted with repugnance to the suggestions made by his Norwegian colleague, Kristen Andersen,[42] that there was a duty of loyalty

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33 Finland was then under Russian rule and did not participate, but enacted its own, also very similar, version in 1929.

34 Stang, F. *Avtalelovens § 33. Dens indhold og dens forhold til forutsætningslæren*, TfR 1930. p. 51.

35 *Id.*

36 *See e.g.* Ussing, H. *Dansk Obligationsret. Almindelig Del*, 1st ed. Gad, Copenhagen 1937, p. 20.

37 Compare Gorton, L. *Best efforts*, in Rättsvetenskapliga studier tillägnade minnet av Knut Rodhe, MercurIUS, Stockholm 1999, p. 99 f., concluding that in Rodhe's "work there is little mention of concepts such as 'good faith', 'loyalty' etc."

38 Committee draft SOU 1974: 83.

39 *See e.g.* Hellner, J. *Lagstiftning inom förmögenhetsrätten*, Juristförlaget, Stockholm 1990, p. 69.

40 Olivecrona, K. *The Legal Theories of Axel Hägerström and Vilhelm Lundstedt*, 3 Sc. St. L. 125 (1959). Schmidt, F., *The Uppsala School of Legal Thinking*, 22 Sc. St. L. 149 (1978).

41 *See e.g.* Lundstedt, V. *Superstition or Rationality in Action for Peace?*, Longmans, Green, and Co., London 1925, p. 131, and Lundstedt, V. *Legal Thinking Revised. My Views on Law*, Almqvist & Wiksell, Stockholm 1956, p. 139: "In the provinces of the law of torts and the law of contract there must, in the nature of things, be extremely little room for any consideration of the points of view of equity and justice."

42 Andersen, K. *Norsk kjøpsrett i hovedtrekk*, 1st ed. Johan Grundt, Tanum Oslo 1945.

embedded in the law of sales and contract.[43] The governmental proposal for a Consumer Sales Act of 1973[44] almost apologizes for infringing the freedom of contract with mandatory rules protecting consumers. In 1980, the Swedish representative, Professor Lars Hjerner, rejected the Canadian suggestion that a party-addressed obligation of good faith should be accentuated in CISG.[45]

A duty of loyalty, however, has long since been accepted in Sweden within certain specific types of contracts, and there are more specified duties applicable to all contracts. For instance, an employee, an agent, a partner or a company director already at that time owed a generally formulated duty of loyalty with respect to the other party. Similarly, the duty to mitigate loss was uncontested in and outside of contracts. Also, judicial review restricted to contracts clearly "contra bonos mores" had occurred, even if the courts did not use that expression, with or without any direct legislative basis.[46] The Nordic contract acts were revised in the late 1970's and the beginning of the 1980's to comprise a general clause as to the review of unconscionable contracts, § 36.

The Swedish position has changed remarkably since Professor Hjerner's speech in 1980. In a draft report for the Swedish Consumer Services Act of 1985, the reporter, Professor Ulf Bernitz, pronounced that a duty of care (in the notion of loyalty) was a general principle within the Swedish law of obligations.[47] Soon enough, similar statements were made in other preparatory legislative works.[48] In 1986, Professor Jan Ramberg made a short reference to contractual loyalty in an introductory treatise to contract law. Then, in 1990, the time was due for the Swedish Supreme Court to find that certain duties of loyalty arose in a case of failed contract negotiations.[49] Now, the vast majority of Swedish lawyers simply assume that there is a general duty of loyalty. In Norway, Denmark and Finland, the existence of the duty of loyalty is accepted by overwhelming authority, even if what good faith means in theory and practice is debated.

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43 Karlgren, H. *[Book review of] Kristen Andersen. Norsk kjøpsrett i hovedtrekk. Oslo 1945*, SvJT 1946 p. 547.

44 Prop. 1973: 138.

45 *See* Honnold, J. O. *Documentary History of the Uniform Law for International Sales*, Kluwer Law and Taxation, Deventer 1989, p. 468.

46 Karlgren, H. *Några synpunkter på den köprättsliga formulärrätten*, JFT 1967 p. 431.

47 Committee draft SOU 1979:36, p. 186. This statement was affirmed in the governmental proposal to parliament, Prop. 1984/85:110, p. 39. Professor Bernitz' opinion might well have been influenced by the Finnish academic Lars Erik Taxell's general treatise on contracts (written in Swedish), in which the principles of reasonabless and loyalty are presented as undisputable basic elements of contract law. Taxell, L. E. *Avtal och rättsskydd*, Åbo akademi, Åbo 1972, p. 81 f.

48 Committee draft, SOU 1986:38, p. 138, and Prop. 1989/90: 77, p. 22 ff. proposing rules on consumer sales of newly built residences (*see* also on the same subject Prop. 2003/04: 45, p. 40 f.). Governmental draft, Ds 1990:44, p. 44 f. and Prop. 1991/92:83, pp. 33 and 106, concerning the revised Consumer Credit Act of 1992. Compare similar reasoning in Prop. 1988/89: 76, p. 23 on the Sale of Goods Act of 1990. Since the beginning of the 1990's, references to a duty of loyalty have increased in the preparatory works.

49 NJA 1990 p. 745.

Although the duty of loyalty is generally accepted in Nordic law, it has no theoretical generally accepted basis. In this respect, there is thus some resemblance between the English and Nordic law. In the Nordic countries there has been theoretical difficulties in accepting a general contractual duty of loyalty. It has no easy-to-find basis in legislation, as is the case of the principle of conscionability. There have been attempts to provide a legislative basis for the duty of loyalty through the induction of a large body of statutory and other default rules, either applicable to contracts in general or specific types of contract, but none of these attempts have been convincing enough. No one, nonetheless, has interpreted this lacuna to pronounce the opposite, *i.e.* that there is no such general duty.[50] So, there is a duty, but it is still hard to explain why. The question from where the duty of loyalty stems has yet not found a convincing answer.

Where good faith is so well-founded as in Norway, the need of finding a cohesive theoretical basis has been less pressing. One might say that the principles of loyalty and conscionability have taken a place next to the principle of freedom of contract. In Sweden, on the other end of the Nordic scale, the urge to explain the existence of good faith is growing. In recent years, this has led academics, at least to circle around the question whether there might be an underlying principle of equivalence, on which unconscionability, a duty of loyalty or a doctrine of abuse of rights is built. Before going deeper into this issue, an overview of the concepts of freedom of contract and good faith and some traditional theories on good faith will be given.

2 The Concept of Good Faith

2.1 Constructive Knowledge and Contractual Good Faith

The concept of good faith is used in different contexts and in different fields of law. Most of the extra-contractual uses of the concept, as for example in administrative or international law, are easy to distinguish from the contractual concept.

Certain uses of the good faith concept however are somewhat harder to separate from the contractual concept. For instance, the rules governing good faith acquisitions (or *bona fide* purchases), which are priority rules applicable outside the contractual relationship,[51] are quite distinct from the notion of good faith in contracts.[52] The concept of good faith in these cases indicates a lack of knowledge of a fact, and finds its opposite in actual and constructive knowledge. German and Nordic law, in contrast to common and French law, do not use good faith terminology for these cases.[53] Good faith with respect to knowledge can

50 However, Kihlman, J. *Köprätten. En introduktion*, 3rd ed. Norstedts Juridik, Stockholm 2002, pp. 63 and 86, might be interpreted as questioning the existence of a general duty of loyalty.

51 *See e.g.* Uniform Commercial Code Art. 1-201(9) (as amended 2001).

52 Lando & Beale, *supra* note 4, p. 116.

53 The expressions in German law ("Guter Glaube") and Nordic law (Swedish: "god tro") can be translated to "good belief". The equivalents to good faith acquisition (*bona fide* purchase)

also be used in connection with rules concerning contractual relations, and even in connection with the application of good faith in contracts, but still has a meaning different than good faith in contracts. However, when using a subjective contractual standard such as "honesty in fact", the distinction between the two notions of good faith becomes blurred.

2.2 Honesty in Fact and Objective Good Faith

The good faith standard can be set at different levels. One may define the good faith requirement as to only prevent dishonesty in a narrow sense[54] or a higher standard of care can be set independent of the inflicting party's state of mind.[55]

> The comment to PECL Article 1:201 defines good faith, surprisingly enough, according to the lesser standard: "'Good faith' means honesty and fairness in mind, which are subjective concepts."[56] This subjective standard, however, is supplemented by the concept of fair dealing, that "means observance of fairness in fact which is an objective test".[57] This is a good example of how the language of PECL is detached from any existing legal tradition, in order to promote harmonisation.[58]

Even if rules against dishonest behaviour have objectives similar to good faith rules based on negligence or some other objective standard, and the latter rules

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are "Gutgläubiger Erwerb" and "godtrosförvärv".

54 English Sale of Goods Act 1979 s. 61(3) ("A thing is deemed to be done in good faith within the meaning of this Act when it is done honestly, whether it is done negligently or not.") and Goode, *supra* note 12, p. 3. Fried, C. *Contract as Promise. A Theory of Contractual Obligation*, Harvard University Press, Cambridge, Mass. 1981, p. 78: "The quintessence of honesty is a Victorian gentleman, who though rigid, perhaps ungenerous, a hard bargainer, keeps his word and does not lie. Honesty assures, first, that one will not mislead another as to the facts in order to profit by the other's misinformed decision. It assures also that engagements once made will be honored. Good faith as honesty may be viewed as a manifestation of the liberal belief in the objectivity of facts, in individual autonomy, and in the importance of keeping one's word." Goode, *supra* note 15, p. 21, uses good faith in this sense.

55 Compare the English and Scottish Law Commission Paper *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties*, LCCP No. 153; SLCDP No. 105, The Stationery Office, London 1998, p. 237. Reporting the current legal standing, the joint commission states under the heading "Loyalty": "The duty is a subjective one ... Provided that the directors act in good faith in what they believe to be the company's interests, it does not matter that their decision also promotes their own interests." The statement is founded upon *Re Smith and Fawcett Ltd.* [1942] Ch. 304 and *Hirsche* v. *Sims* [1894] A.C. 654. The commission has completed its work and proposed an objective standard. An "objective/subjective test" is suggested. The subjective level is to apply where the person in question possesses greater knowledge than normal in the situation. *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties*, Law Com. No. 261; Scot. Law Com. No. 173, The Stationery Office, London 1999, p. 48 f.

56 Lando & Beale, *supra* note 4, p. 115.

57 *Ibid.*, p. 115 f.

58 Compare *ibid.*, p. xxi.

also apply to dishonesty, it is not sufficient to label them good faith rules.[59] Accordingly, only rules based on objective standards should be counted as good faith rules when investigating whether a legal system has sufficient support to claim a general principle of good faith.[60]

2.3 Unconscionability and Loyalty

The good faith concepts in civil law protect a party from unconscionable contracts as well as the other party's lack of loyalty. In Nordic law, there is no homogenous good faith concept such as the ones found in civil law jurisdictions.[61] Quite the opposite, a clear distinction is made between conscionability and loyalty, and the concepts most often used are the principle of conscionability (or reasonableness or fairness)[62] and the principle or duty of loyalty.[63] In sharp contrast to civil law, the connection between them is not apparent on the surface.[64] In common law, there seems to be a somewhat similar approach as in Nordic law,[65] even if one *may* see them as one or at least as closely connected.[66] Also, the implementation of the EC Directive on Unfair Contracts Terms in Consumer Contracts[67] seems to have caused some disturbance in England.[68] One reason for this could be that the fairness test refers

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59 *Interfoto Picture Library Ltd.* v. *Stiletto Visual Programmes Ltd.* [1989] 433, 1 All ER 348, CA, per Bingham LJ: "In many civil law systems, and perhaps in most legal systems outside the common law world, the law 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 ..."

60 Of course, any *application* of law can be considered "subjective". *See e.g.* MacCormick, N. *Reasonableness and Objectivity*, 74 Notre Dame L. Rev. 1575 (1998–1999), in discussing the legal concept of reasonableness, concludes (at 1603) that "there is bound to be for each of us an element of the subjective in every one of our best efforts of pure objectivity".

61 In France, though, it is common to refer not only to "bonne foi" but also to "clauses abusives" and "obligation de loyauté" separately.

62 In Swedish: *skälighetsprincipen.*

63 In Swedish: *lojalitetsprincipen*; *lojalitetsplikten.*

64 According to quite recent Norwegian court precedents and to some Norwegian authors, there is a connection, *See e.g.* Rt 1994.833 and Wilhelmsen, T.-L. *Avtaleloven § 36 og økonomisk effektivitet*, TfR 1995. p. 21 with references in note 45. In Sweden, this connection has been accepted by a few. Holm, A. *Den avtalsgrundade lojalitetsplikten – en allmän rättsprincip*, Linköpings universitet, Linköping 2004, *passim*, is most in favour. I share this view.

65 In U.S. law, the concepts of good faith and unconscionability seem to be relatively clearly separated. In the Uniform Commercial Code. Art. 1-203 or its comments, reference is not made to conscionability, and Art. 2–302(1) or its comments, do not make reference to good faith. *See* also Fried, C. *Contract as Promise* (1981) p. 74. In Australia, the distinction seems to be less pronounced. Peden, E. *supra* note 22, p. 168 f. Priestley JA, *Contract – The Burgeoning Maelstrom*, (1988) 1 JCL 19 ff. and 28 f.

66 MacDonald Eggers, P., Pickens, S. & Foss, P. *Good Faith and Insurance Contracts*, Lloyd's of London Press, London 2004, p. 5. O'Connor, J. F. *The Concept of Good Faith in Legal Theory*, Institute of Advanced Legal Studies, London 1987, p. 11.

67 Council Directive 93/13/EEC, 5 April 1993, OJ L 95/29, 21/4/93.

68 *See e.g.* Collins, H. *Good Faith in European Contract Law* (1994) 14 O.J.L.S. 249 ff.

to good faith as a normative threshold.[69] In my mind, the reference to good faith does not heighten the requirements. Instead, the wording of the article gives the impression that the good faith norm might give relief where there is a significant imbalance not caused by a good faith breach. However, such an interpretation might not be intended.[70] Mixing the concepts of unfairness and good faith in this manner might be awkward to most legal traditions. While the German version of the directive and the act of implementation uses "Treu und Glauben",[71] the French act of implementation leaves out "bonne foi",[72] despite that the directive refers to that expression.[73] In the Swedish and Finnish translations[74] of the directive, "god sed" (good usage) has been chosen and the Danish version uses "god tro" (good belief),[75] even if referral could have been made to "loyalty". Apparently, the combination of conscionability and good faith is confusing not only in common law.

The legislation, similar in all Nordic countries, permits court review of contract terms. In addition to legislation as to "procedural unfairness" such as fraud, duress and undue influence, there is a general clause allowing court intervention. Adjustment or annulment of a contract term is possible on simply "substantive" and "objective" grounds, whenever a significant imbalance is revealed. The court is to consider all (invoked) circumstances, including those arising after the formation of the contract. If a term, or the contract as a whole, is

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69 Art. 3(1), implemented with the same text in Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999 No. 2083), reg. 5(1): "A contractual term which has not been individually negotiated shall be regarded as 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." Compare Department of Trading and Industry 1995 Guide, para AI.4, stating that "the key element of the test of fairness is that of good faith and that where a seller or supplier has dealt fairly and equitably with a consumer, that requirement will be satisfied".

70 Brownsword, R., Howells, G. & Wilhelmsson, T. *The EC Unfair Contract Terms Directive and Welfarism*, in Brownsword, R., Howells, G. & Wilhelmsson, T., Welfarism in Contract Law, Dartmounth, Aldershot 1994, p. 279 ff.

71 Richtlinie 93/13/EWG des Rates vom 5. April 1993 über mißbräuchliche Klauseln in Verbraucherverträgen, Artikel 3, implemented by AGBG § 9. Note that this is not the case with the German translation of CISG Art. 7(1), where the expression "guten Glaubens" is used instead.

72 Code de la consommation, Article 132-1 alinéa 1: "Dans les contrats conclus entre professionnels et non-professionnels ou consommateurs, sont abusives les clauses qui ont pour objet ou pour effet de créer, au détriment du non-professionnel ou du consommateur, un déséquilibre significatif entre les droits et obligations des parties au contrat".

73 Directive 93/13/CEE du Conseil, du 5 avril 1993, concernant les clauses abusives dans les contrats conclus avec les consommateurs, Art. 3(1): "Une clause d'un contrat n'ayant pas fait l'objet d'une négociation individuelle est considérée comme abusive lorsque, en dépit de l'exigence de bonne foi, elle crée au détriment du consommateur un déséquilibre significatif entre les droits et obligations des parties découlant du contrat."

74 Unofficial texts since Sweden and Finland did not become members of the EU until 1995: Rådets direktiv 93/13/EEG av den 5 april 1993 om oskäliga villkor i konsumentavtal, artikel 3.1. Neuvoston direktiivi 93/13/ETY, annettu 5 päivänä huhtikuuta 1993, kuluttaja-sopimusten kohtuuttomista ehdoista, 3 artikla.

75 Rådets direktiv 93/13/EØF af 5. april 1993 om urimelige kontraktvilkaar i forbrugeraftaler, article 3.1.

otherwise deemed to be unfair, a defence entirely based on either "honesty in fact" or on the absence of negligence will be in vain. The general clause is not restricted to the protection of weaker parties, even if it is rarely applied outside of consumer relations. Consequently, the test is neither "procedural" nor "subjective", and it seems correct to state that these rules are primarily addressed to the courts. One may, of course, always contend that all rules addressed to courts ricochet back to the parties, and thus give guidelines as to future conduct, but in this case, this proposes either the existence of a party-addressed, extra-judicial duty to refrain from invoking unfair contract terms or a duty to renegotiate the contract. The majority view hardly supports such a proposition.

Good faith, however, is much more than the judicial review of contract terms. As noted above, good faith translated into Nordic legal concepts also comprises the duty of loyalty. This duty, according to the academic definition used in all Nordic countries, compels the parties to a contract to have due regard to the other party's interests. The loyalty therefore is to be shown primarily to the other party, and not the contract itself. The duty of loyalty is clearly addressed to the parties and it concerns their behaviour instead of the terms agreed upon. The duty of loyalty works as a basis for supplementing the contract with obligations of secondary character,[76] restriction of abuse of rights[77] and pre-contractual liability.[78]

3 Good Faith and Freedom of Contract

Since the breakthrough of industrialism and liberalism, Western states have refrained from interfering with the private dealings of the population, in the conviction that the respect shown for the free choice of individuals will be prosperous for the state as a whole and to the benefit of all individuals. However, freedom of contract cannot be used as an isolated argument against the acceptance of good faith, or *vice versa* for that matter.[79]

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76 *See e.g.* the Swedish appeal court case RH 2001:77, where a building contractor was found to be in breach of loyalty, not having reported difficulties emerging during dredging a small boat marina.

77 *See e.g.* the Danish Supreme Court case U 1981.300 H, where an oil company was ordered to accept a bank guarantee in exchange of relieving a mortgaged piece of land owned by a gas station tenant, which the tenant wanted to exploit commercially. The court found that the refusal to substitute security was done only in order to put pressure on the tenant to accept a conciliation in a dispute over the terms of tenancy and that the refusal lacked any loyal ground.

78 *See e.g.* the Swedish Supreme Court case NJA 1990 p. 745. The court recognised that the parties' negotiation process had reached so far that certain duties of loyalty had arisen. Even though the party breaking off the negotiations was blamed by the Supreme Court for not disclosing its decision to abstain from entering a contract for almost a month, the circumstances were not enough to give rise to liability. *See* also the Finnish Supreme Court case KKO 1993:130. The quay of a large port was damaged due to insufficient bumpering. The contractor who built the port was held to be in breach of the duty of loyalty, already during the tendering process, by not telling the developer (a city) that the planned rubber fenders could not be replaced with wooden fenders.

79 Compare Hellner, J. *Pacta sunt servanda*, in Samfunn Rett Rettferdighet. Festskrift til Torstein Eckhoff, Oslo 1986, p. 335 ff., at 349, stating that *pacta sunt servanda*, even if it

As mentioned, good faith and freedom of contract are often found on opposite sides working in different directions, as repellents. In other cases, freedom of contract and good faith orient in the same direction. This paradox is explained by the unspecified use of the expression "freedom of contract". The principle of freedom of contract might be seen as composed of mainly three functions or underlying separable liberties or rights. One could define these as follows: (1) The *freedom of contracting* renders a liberty to enter and abstain from contracts. It gives individuals the right to engage in contracting with whom they desire. (2) The *principle of the binding force of contract* (or *sanctity of contract*)[80] ties the parties to their promises (*pacta sunt servanda*). (3) The *freedom of negotiation* means party autonomy, and that freely chosen contract terma are to be respected by the courts. When conflicts between freedom of contract and good faith arise, lawyers often find themselves left with not much more guidance than their individual "legal intuition". Specifying the actual function in conflict with good faith will not immediately undo the knots, but it at least will work as a tool for further analyses.

For instance, when an agreement of terms is reached, although lacking formal completion, a party may invoke good faith in order to make the contract binding or to make the other party liable for some pre-contractual fault.[81] The good faith argument in this case seems to clash with the freedom of contract, but not with *all* of its functions. Here, it is only the freedom of contracting, more specifically its negative side – the liberty to abstain from contracting – that is in question. In fact, the good faith argument in this pre-contractual example seems even to support another function of the freedom of contract, namely the binding force of contract.

Must good faith and freedom of contract really be confined to opposite corners? No, absolutely not. In Roman law, where a mere agreement was not enough to establish the binding force of the contract, there was no general principle of *pacta sunt servanda*.[82] Only agreements supported by a formally correct ritual *and* a procedural action could be called truly binding. In such a legal environment, it is not surprising that safety valves developed along the way. In Roman law, the safety vault was *bona fides*. This development led to that contracts *bona fides* eventually were considered the rule and contracts *stricto jure* the exception. So in the beginning, good faith was supporting freedom of contract and party autonomy.[83] We may call this the *support perspective*.

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works as a practical rule in a large number of cases, is inappropriate as an argument in legal debate. Compare also Collins, H. *Regulating Contracts*, Oxford University Press, Oxford 1999, p. 32 f.

80 Whittaker (ed.), *supra* note 20, p. 14.

81 Compare the Swedish Supreme Court cases NJA 1973 p. 175 and NJA 1978 p. 147, and the appellate court cases RH 1990: 26 and RH 1996: 154, all disallowing pre-contractual liability.

82 *See e.g.* Zimmermann, R. *The Law of Obligations. Roman Foundations of the Civilian Tradition*, Juta & Co, Cape Town/Wetton/Johannesburg 1990, reprint 1992, p. 622 f.

83 Zimmermann, *supra* note 82, p. 636 f. with note 94, stating also that the German counterpart Treu und Glauben have been "instrumental in the shaping" of first the will theory based focus on intention and later the declaration and reliance theories focus on the consequences of

What about modern conditions? Good faith can still be used in support of consensual agreement, especially in cases of lack of legally required form,[84] but in a modified sense also in cases of implied terms, abuse of contractual rights, *etc*. This shows the broad applicability of the support perspective: It works in all stages of contract: formation, performance and enforcement. Consistent with this, there have been attempts to explain the relation between freedom of contract and good faith, as one being the source of the other, or both of them striving in the same direction, towards fulfilment of the underlying purpose or spirit of the agreement.[85]

Nonetheless, the support perspective must be contested. The modification required in most cases to make freedom of contract and good faith work in the same direction is theoretically disturbing. For instance, in the absence of a good faith atmosphere in law, one would not be able to imply anything that was not implied in fact by the parties. So, in applying the contract, the courts would have to follow the principle of party autonomy more or less blindly, and enforce the actual agreement. However, in many cases courts do take into account more than the agreement in fact. The contract applied by the court is therefore a compromised version of the actual agreement, seemingly to be in favour of the support perspective, but the result in such a case is not found at the end of a straight line drawn from freedom of contract as a starting point. According to a *counter perspective*, the result is found between the contraries freedom of contract and good faith.

However, the counter perspective is also problematic, since the functions of freedom of contract do not always coincide, and one or more of the functions may be found on the same side as good faith. In fact, freedom of contracting in its positive sense is very seldom seen to be in conflict with good faith.[86] It might therefore be advantageous, from a systematic point of view, to adopt a *prism perspective*. Good faith may be described as a prism, through which freedom of contract is seen. This prism corrects distortions of the underlying ideas of freedom of contract. If the picture, as seen without the prism, appears disproportional considering all circumstances of the case, the good faith norm comes into play. If a contract is not brought to formal completion, good faith ought to be allowed to remedy the lacking form only if this seems more in line with the ideas of the surrounding legal environment than not. Considering the benefits of form, one must almost without exception find that not upholding the form requirements would in itself contravene good faith.

How often the good faith prism alters the picture depends on the function of good faith considered and on what is seen on the picture. In the vast majority of cases, the prism does not at all or only slightly alters the picture, if the picture

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contractual behaviour.

84 Gernhuber, J. *Formnichtigkeit und Treu und Glauben*, in Festschrift zum 70. Geburtstag von Walter Schmidt-Rimpler, C. F. Müller, Karlsruhe 1957, p. 151 ff. and Gernhuber, J. *Handbuch der Schuldrechts. Band 8. Das Schuldverhältnis*, J. C. B. Mohr, Tübingen 1989, p. 187 f.

85 Cf. Nassar, N. *Sanctity of Contracts Revisited*, Martinus Nijhoff, Dordrecht p. 241 ff.

86 This was, however, the case in Germany during the Nazi period, where contracts with Jews were deemed to be contrary to good usages (gute Sitten) or good faith (Treu und Glauben). *See e.g.* Jaluzot, *supra* note 7, p. 49.

seen is the current law. The good faith norm is then a remedy used in hard cases. If the picture seen, on the other hand, is only the contract, and not the applicable default rules, good faith can be viewed as a source of secondary obligations, supplementing almost every contract. In English law, the hard case view prevails, while in civil law, especially German law, although of course also acknowledging good faith as a remedy in hard cases, the opposite view has been taken.

4 Theoretical Foundations of a Good Faith Norm

4.1 Morality and Justice

Good faith not seldom is seen as a principle of contractual justice.[87] If, for instance, a formal requirement turns out to "prevent justice" in a certain case, and good faith is applied to cure the problem, good faith can be equalled with justice. This reflection, however, is caused by the regulative effect good faith has on the normative environment it is called upon to supplement. Labelling good faith as a norm of justice will not help much, since most legal norms might be seen as striving towards justice. The principle of the binding force of the contract, supported by voluntaristic and reliance theories, can be considered as one of the most fundamental principles of justice.

Even if the concept of justice exists in Nordic contract law,[88] usually used in connection with the concept of conscionability, it is hard for the Nordic contract lawyer to grasp. Arguments based on justice are still very much met with scepticism.[89] This view is probably held even more strongly in English law, even if the concept itself is used quite often as an underlying explanation for the law.

Using the moral argument as a primary one within legal orders which have not yet admitted the concept as a basic contractual norm, such as in English, Irish and Swedish law, places a strain on the possibilities of accepting good faith. The moral argument has so little strength that it cannot convincingly be put forward alone. Therefore, an alternative theoretical basis is required for the concept to have any possibility for international acceptance.

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87 *See e.g.* Summers, R. S. *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 198 (1968), and Jaluzot, *supra* note 7, p. 61 ff.

88 *See e.g.* Hellner, J. *Scandinavian Legal Realism in the Law of Contract*, in Cane & Stapleton, *supra* note 19, p. 53 ff.

89 Aarnio, A. *Värdena och domarreglerna*, in Festskrift till Jan Hellner, Norstedts, Stockholm 1984, p. 11, contends that fighting arbitrariness is a cornerstone of Scandinavian law. Rodhe, K. *Obligationsrätt*, Norstedts, Stockholm 1956, p. 7 ff., finds that courts often have to supplement contracts with usage, default rules and – as a last way out – discretion. Compare similar views in Burton, S. J. *Judging in Good Faith*, Cambridge University Press, New York, N.Y. 1992, p. 37 ff.

4.2 Mutually Expressed Intent

As mentioned above, the principle of the binding force of the contract, was seen as an expression of good faith in Roman law, and that in some instances it might still be seen as such.[90]

If parties to a contract have explicitly agreed to a term, freedom of negotiation normally ensures that the term is respected. A legal order can limit the effects of certain terms with mandatory rules or principles. Legal actions contrary to public policy, for instance some contracts affecting third parties negatively, contracts with criminal content, or with the effect of diminishing the rights of a consumer, are textbook examples. In accordance with the freedom of negotiation, the parties must be expected to have the right to explicitly include good faith requirements in their contract. Legal orders that find such agreements disturbing, of course can limit the right to include good faith in relationships. However, if the reason for not accepting good faith is the general obscurity of good faith terms, this is not a limitation of the freedom of negotiation, it is merely an incapacity as to assessing the meaning of contract terms. It is therefore difficult to understand why a legal order, such as English law, states that agreements to negotiate in good faith are not binding.[91] It can be understood that legal orders highly appreciating freedom of contracting in its negative sense cannot find agreements to agree binding,[92] but this is just one odd type of term of good faith negotiation. A generally formulated good faith term might or might not, for instance, be interpreted as preventing competition or negotiations with others during the negotiation process, or the utilisation of the other party's ideas during or after negotiations.

Explicit terms are by no means the only way to include good faith measures in legal relations. Good faith standards, even though not explicitly stated themselves, can be construed from other explicit terms,[93] so called implication by construction, or just construction. Moreover, probably the most important form of inferring good faith requirements in contracts is in the terms implied.[94]

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90 In fact, the obligation to perform according to a written contract has been explained by "the obligation of good faith" in American case law, *Brassil* v. *Maryland Causalty Co.*, 210 N.Y. 235, 104 N.E. 622 (1914).

91 *Walford and Other Appellants* v. *Miles and Another Respondent* [1992] 2 A.C. 128.

92 This position however has been critisised for not enabling a nuanced view on pre-contractual liability, *See e.g.* Summers R. S. & Hillman, R. A. *Contract and Related Obligation. Theory, Doctrine, and Practice*, 4th ed. West, St. Paul, Minn. 2001, p. 41 citing Fuller.

93 *See e.g.* the Swedish Supreme Court case, NJA 1962 p. 359, where it was found that the contractual relation demanded a high level of loyalty and confidence, and that one of the parties failed to meet these requirements, which is why the other party was entitled to terminate the relationship. According to Lehrberg, B. *Avtalstolkning*, 3rd ed., Institutet för Bank- och Affärsjuridik, Uppsala 2003, p. 30, rules of interpretation ought to give parties incentives to behave loyally both in negotiations and after the formation of the contract. *See* also Peden, *supra* note 22, *passim.*

94 Compare. Farnsworth, E. A *Good Faith Performance and Commercial Reasonableness Under the U.C.C.*, 30 U. Chi. L. Rev. 666 (1963), and. Ebke, W & Steinhauer, B. *Good Faith in German Contract Law*, in J. Beatson & D. Friedman (eds.), Good Faith and Fault in Contract Law, Oxford University Press, Oxford 1995, p. 177.

4.3 Implied Terms and Default Law

The parties may inply terms. If so, they have intended the contract to be supplemented with these unspoken terms. Implication in fact therefore is founded on mutual intent.

If good faith can be explained with the construction of terms, the parties should likewise be free to imply such standards, unless certain form is required.

Is implication in fact a sufficient explanation to the instances in which good faith is found to exist? Actual and mutual intent as a requirement would incapacitate much of the idea of good faith as a norm for hard cases. Not only would the instances of actual contemplation, for instance, of secondary obligations in cases of irregular development be next to nil, the party invoking such an obligation would also have bear the burden of proof.

Furthermore, having to base good faith on mutual intent probably would lead to ficticious fact finding. This, I think, is a result of the combination of circumstances that jurists tend to find the default order just, and that convincing power accumulated by the history of repeated ordinary courses of business.[95] These two elements form patterns, from which far-reaching deviations are disturbing to lawyers' senses of justice.

Implication can also be made in law. Finding an implication in law is an operation external to the parties' state of minds, which brings a rule, found in the background law of the particular type of contract, into the contract at hand.[96] In continental European law, other expressions other than implication are preferred for this phenomenon. Such terms are sometimes, especially when it comes to secondary obligations, called *naturalia negotii*.

Implication in law can be described as a process of applying default rules.[97] Applying default rules is certainly a very important mode of operation regarding good faith. All jurisdictions relying on a good faith principle or good faith legislation, that is not considered mandatory, would attach the good faith requirement to the contract in very much the same way as is done in a process of legal implication.

Referring to default rules though does not give sufficient answers as to the theoretical basis of good faith in jurisdictions where the assessment of a default rule on good faith is uncertain. It is circular to say that a good faith norm exists because it is a default rule. In Swedish case law, courts have mostly applied such default rules either by analogy of statutory good faith requirements[98] or by

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95 Compare White & Summers, *supra* note 17, p. 16 ff., finding that good faith in the UCC makes it easier for judges to combine law and justice. *See* also Karlgren, H. *Säkerhetsöverlåtelse enligt svensk rättspraxis*, Norstedts, Stockholm 1959, p. 195. This phenomenon in Nordic law is called "hidden court control" (*dold domstolskontroll*), whereas the expression "disguised court control" (*förtäckt domstolskontroll*) would be to prefer.

96 Rakoff, T. D. *The Implied Terms of Contracts: Of 'Default Rules' and 'Situation Sense'*, Beatson & Friedman, *supra* note 94, p. 191 ff. Rackoff describes two ways of implication in law. One is to first find that the parties have not agreed as to any relevant term, and then bring in the rule implied in law and adjust it to the contract. Another way is to start from the implied term, and then find that there is no agreement to nullify the implied term.

97 *Id.*

98 Supreme Court: NJA 1916 p. 158 (The seller had by mistake sent the goods to the wrong

applying tort-like reasoning,[99] and only seldom by making references to a general, contractual duty of loyalty.[100]

4.4 Reliance and Expectations

A rule based on justifiable reliance or expectations covers much of the assumed good faith dominion.[101] The parties may actually place their trust in that the other party will, for instance, disclose all material facts. The weakness of such a requirement, however, is much the same as that the implication in fact suffers from. Actual reliance, however, of course can be used as an explanation for the existence of a general or a specific duty of good faith in the case concerned. Still, even if this explanation, together with the previously mentioned, covers many of the instances where good faith norms are applied, it does not give sufficient coverage.

For instance, secondary obligations that might seem to be of minor importance at the time of contracting, generally will not be relied upon in fact since they are often neglected; they simply are not thought of. One assumes generally, of course, that one will not be deceived or taken advantage of, but this mental state cannot be used as to operate as, for instance, a prevention of abuse of a specific right in the contract. A legal order may of course accept hypothetical reliance as a legal norm, but would this not be the same as adopting a party-external objective duty of good faith?

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trainstation, which according to the terms of contract had the effect that the goods had not been delivered. The buyer was notified by the station, but did not take any action. When the seller demanded payment, the buyer avoided the contract on grounds of late delivery. The duty to notify, according to the Sale of Goods Act of 1905, arise until delivery had taken place. Despite this, the court found by analogy that the buyer had lost his right to avoid the contract due to late notification). Court of Appeal: RH 2001:77 (applying consumer law rules in a commercial relationship).

99 Supreme Court: NJA 1990 p. 745 (party deciding not to continue negotiations, was in undue delay in informing the other party of its decision). Court of Appeal: RH 2000:62 (tenant started to rebuild spaces to adapt them to a restaurant; landlord failed to disclose that a former tenant's recent application for opening a restaurant in the same space was rejected by the building council).

100 *See* the judgment of a trial court, Stockholms tingsrätts dom 2002-06-11; mål nr T 16349-00, in which the Swedish government was found to have publicly miscredited a contractual counterpart in such a manner that it breached the general contractual duty of loyalty, and the judgment of the appeal court in the same case, Svea hovrätts dom 2003-06-19; mål nr T 4712-02, where no breach was found for lack of sufficient evidence, although the appeal court seemed to accept a contractual duty of loyalty. *See* also the decision of the Swedish Panel on Take-Overs and Mergers, AMN 2000:20, which was founded on the general duty of loyalty in the law of obligations.

101 *See e.g.* Burton & Anderson, *supra* note 26, p. 52 ff.

5 Contractual Proportionality

The best way to connect the differing views on what good faith is and ought to be, is to find a common denominator for these views. None of the concepts of honesty, morality, reliance, implication or construction stand the test. However, contractual proportionality does. This might work as the theoretical basis in legal systems that have found it difficult to explain many, but seemingly disparate, occurances of good faith requirements. Contractual proportionality certainly covers more than "needed", since it also can be used to explain the policing of contractual terms and unjust enrichment. The lack of a better explanation, however, should not disqualify this theory.

In cases of alleged unfair contracts, it is quite clear that the fairness test is one of balancing the parties' positions by weighing the obligations and remunerations, risks and levels of knowledge. If there is too much weight on one side, the terms will be altered.[102]

This principle also works in respect of the duty of loyalty. This obligation is based on negligence and, therefore, does not require the impossible or the impracticable. It is mouldable enough to recognise that even minor breaches of contract can lead to termination, if the contract demands strict compliance.

If a buyer has made it clear that delivery at a fixed date is of utmost importance, so that the seller has accepted the risk of the buyer avoiding the contract in the case of any early or late delivery,[103] there is rarely anything disproportional, or, in other words, contravening good faith requirements, in holding for the buyer, since a breach of a condition will normally be considered fundamental.[104] Demands of strict compliance cannot, however, be allowed to be misused.[105] For instance, if timely delivery is of great importance for the buyer, this cannot immediately be taken to mean that a strict compliance measure is to be applied in *all* regards.

The consideration of proportionality is thus central in the assertion of the abuse of rights.[106] There are policy arguments founded in "legal darwinism" that challenge the idea of abuse of rights, but there are no theoretical difficulties in classifying avoidance in cases of immaterial breaches as disproportional.

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102 *See e.g.* the German Federal Supreme Court's decision BGH 14 Okt. 1959, NJW 1959, p. 2203, where the court uses the expression "Störung des Äquivalenzverhältnisses" and Bydlinski, F. *System und Prinzipien des Privatrechts*, Springer, Wien 1996, p. 156 ff.

103 *Cf. Bunge Corporation* v. *Tradax Export S.A.*, [1981] 2 Lloyd's Rep. 1 HL and McKendrick, E. *Traditional Concepts and Contemporary Values* (2002) 10 European Review of Private Law 95.

104 *Cf.* PECL Art. 8:103(a) and Lando O. & Beale, H. (eds.), *supra* note 10, p. 364.

105 *Cf.* the Ontario Court of Justice case *Watchfield Developments Inc.* v. *Oxford Elgin Developments Ltd.*, 1992 CarswellOnt 596; (1992) 25 R.P.R. (2d) 236 (Ont. Gen. Div.), where the purchaser of land could not rely on a "time is of essence" rescission clause, requiring that registration of the sale should be completed at a certain date, since the purchaser failed to show willingness to accept a preliminary registration when registration could not be completed due to formal registration requirements. *See* also O. Lando & H. Beale (eds.), *supra* note 10, p. 113.

106 Evald, J. *Retsmisbrug i formueretten*, Jurist- og Økonomforbundets Forlag, Copenhagen 2001, p. 27 ff.

The principle of contractual proportionality also functions in relation to the assessment of secondary obligations. Such obligations that are considered natural in the contract type or the actual contract concerned will be imposed if nothing in the actual relationship prevents this.

In German law, there is a principle of equivalence used in connection with good faith,[107] which has recently been considered in Swedish literature.[108] The term equivalence gives the impression that the outcomes on both sides have to be equivalent to each other. I would rather think that the outcomes and the obligations ought to be proportional to the position on each side and to each other, considering all the circumstances in all stages of the contract. However, other similar expressions are used in German law, all of which may be gathered under a principle of proportionality.[109] A principle of contractual proportionality has also recently been discussed in French law.[110]

Since all contractual relationships differ, the sensitivity of the situation must be appreciated. A principle of contractual proportionality therefore is not a way to reestablish the Canon law idea of a fixed just price, *justum pretium*.[111]

A principle of contractual proportionality, it might be argued, cannot be anything else than a renamed principle of contractual morality. In a way, this is true. Since "legal morality" or "sense of justice" is built upon the perception of the rules that normally apply (ethically just or not), this is also the case in the operation of a proportionality principle. When looking for the "correct" solution, the jurist however will not be left with a license to apply morals, but to apply the norms, including the terms of contract, proportionally.

A duty of good faith built on a principle of proportionality has the strength that it can be adopted by any legal order, and thus create a common ground for comparison and discussion. It is less obscure in meaning than morality, and actually gives guidance already by its connotation. It also covers all functions of the Western legal concepts of good faith.

Naturally we will have to wait a long time until anything resembling harmonisation come true in the area of international contract law. Hopefully though, the lengthy process will guarantee a systematically contemplated and practically workable set of rules. Coming to terms with the mysticism surrounding the concept of good faith will probably occupy generations of lawyers to come. Accepting that we cannot create a perfect order, and that – unless we cheat by employing fictions – we need correctional measures such as good faith, will be a leap in the right direction.

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107 *See e.g.* Bydlinski, *supra* note 102, p. 156 ff.

108 In connection with judicial review of contracts, *see* Dotevall, R. *Ekvivalensprincipen och jämkning av långvariga avtal*, SvJT 2002 p. 441 ff. For a brief consideration in connection with the duty of loyalty, *see* Holm, A. *supra* note 64, pp. 31 f. and 273 f.

109 Jaluzot, *supra* note 7, p. 273.

110 *Ibid.*, p. 273 ff., se also p. 257 ff.

111 Compare Wilhelmsson, T. *Contract and Equality*, 40 Sc. St. L. 145 (2000), discussing a principle of *equality*, that might be of an effect similar to *justum pretium*.