

THE CONCEPT OF GOOD FAITH IN THE UNIDROIT PRINCIPLES FOR INTERNATIONAL COMMERCIAL CONTRACTS

ARTHUR HARTKAMP*

Article 1.7 of the UNIDROIT Principles of International Commercial Contracts (Principles) requires each contracting party to “act in accordance with *good faith and fair dealing* in international trade.”¹ What exactly does this mean?

In civilian legal doctrine, which generally has more experience with the principle of good faith than the common law,² the good faith principle performs three functions. First, all contracts must be interpreted according to good faith. Where the intentions of the parties are unclear, a court should interpret a contract according to the meaning that reasonable parties would give to it and not by the literal terms of the agreement.³ Second, good faith has a “supplementing” function. Supplementary rights and duties not expressly provided in the contract or in statutory law may arise between the parties.⁴ This is equivalent to the common law’s “implication of terms” doctrine.⁵ Third, good faith has a “derogating” or “restrictive” function. A rule which binds the parties and is provided in

* Arthur Hartkamp, Advocate-General of the Supreme Court of the Netherlands; Professor of Private Law, Utrecht University; Member of the Study Group for the Elaboration of Principles for International Contracts; Member of the Governing Council of UNIDROIT.

1. INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW, PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (1994) [hereinafter UNIDROIT PRINCIPLES].

2. The exception is U. S. contract law, which has adopted the concepts of *good faith and fair dealing*. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); U.C.C. § 1-203 (1990).

3. 4-II ASSER & HARTKAMP, VERBINTENISSENRECHT [THE LAW OF OBLIGATIONS] § 281 (1992); M.E. STORME, DE INVLOED VAN DE GOEDE TROUW OP DE KONTRAKTUELE SCHULDVORDERINGEN [THE INFLUENCE OF GOOD FAITH ON CONTRACTUALLY ENFORCEABLE DEBTS] 99 *et seq.* (1989); LARENZ, ALLGEMEINER TEIL DES DEUTSCHEN BÜRGERLICHEN RECHTS [GENERAL PART OF THE GERMAN CIVIL LAW] 339 (1989); GHESTIN & BILLIAU, TRAITÉ DE DROIT CIVIL: LES OBLIGATIONS, LES EFFETS DU CONTRAT [TREATISE OF CIVIL LAW, OBLIGATIONS, CONTRACTUAL EFFECTS] §§ 9, 47-48 (1992).

4. ASSER & HARTKAMP, *supra* note 3, § 307; LARENZ, *supra* note 3, at 548; GHESTIN & BILLIAU, *supra* note 3, § 43; III LARROUMET, DROIT CIVIL § 594 (1990); TUOR & SCHNYDER, DAS SCHWEIZERISCHE ZIVILGESETZBUCH [THE SWISS CIVIL CODE] 46-47 (1986).

5. CHESHIRE, FIFOOT, & FURMSTON, CHESHIRE, FIFOOT, AND FURMSTON’S LAW OF CONTRACT 141 (1991).

either the text of the agreement or by statute does not apply to the extent that its effect would be contrary to good faith.⁶ The restrictive function of good faith has spawned several doctrines, including the adaptation of contracts in changed circumstances, the review of unreasonable contract clauses, and estoppel.⁷

The distinction between these functions is not always clear. It may be difficult to differentiate between the interpretation and the implication of terms.⁸ It is also sometimes difficult to distinguish between the supplementing and restrictive functions. For example, when a term making a party's duties conditional on the other party's performance is not provided by the contract or by statute, but is instead implied, that implied term both supplements the rights of the party permitted to suspend performance and restricts the other party's right to claim performance under the contract's literal terms. The same result occurs where a term is implied as to permit a party to terminate a contract in which the literal terms do not provide for the right to terminate.

Despite this overlap, the distinction between these functions is useful for theoretical purposes. For obvious reasons, many countries more fervently oppose the use of the restrictive function than the supplementing function, especially where the restrictive function would lead to the setting aside of an entire contract or the non-application of otherwise applicable, even perhaps mandatory, statutory rules.⁹

One might expect the civil codes of the European continental legal systems to clearly denote which functions of good faith are recognized under the countries' codified systems of law. This, however, is not the case. For instance, all systems accept, at least to some extent,

6. This brief survey is restricted to the performance and enforcement of contracts. Good faith may also give rise to duties outside the scope of an existing contract, for instance, in the negotiation phase preceding the conclusion (or nonconclusion) of a contract. See UNIDROIT PRINCIPLES, *supra* note 1, art. 2.14.

7. The form of "estoppel" referred to here would, for example, precludes a party from invoking a clause of the contract if, by the party's previous conduct, he has induced the other party into believing that he himself would not rely on the clause. In German, this is entitled *Verwirkung*.

8. Both Dutch and German law allow for omitted terms of a contract to be supplied in accordance with good faith. In Germany, this practice is called *ergänzende Vertragsauslegung*.

9. GHESTIN, TRAITÉ DE DROIT CIVIL: LE FORMATION DU CONTRAT [TREATISE OF CIVIL LAW, CONTRACT FORMATION] §§ 184-186 (1988); GHESTIN & BILLIAU, *supra* note 3, § 260; ASSER & HARTKAMP, *supra* note 3, §§ 312, 329; P. ABAS, REBUS SIC STANTIBUS, EINE UNTERSUCHUNG ZUR ANWENDUNG DER CLAUSULA REBUS SIC STANTIBUS IN DER RECHTSPRECHUNG EINIGER EUROPÄISCHER LÄNDER [REBUS SIC STANTIBUS: AN EXAMINATION OF THE USE OF REBUS SIC STANTIBUS CLAUSE IN THE JURISDICTIONS OF CERTAIN EUROPEAN COUNTRIES] (1993).

the function of good faith in the interpretation of contracts. Explicit statements to this effect are found in the German¹⁰ and the Italian¹¹ Civil Codes, but not in the French,¹² Belgian¹³, or Dutch¹⁴ Codes. The supplementary function of good faith or, more broadly, of equity, is expressed in the French¹⁵, Italian¹⁶, and Dutch¹⁷ Codes,¹⁸ but not in the German or Swiss Codes. Nevertheless, the principle is accepted in these latter systems.¹⁹

Finally, the most problematic function is the restrictive function of good faith. The only civil code which clearly expresses this notion is the new Dutch Code of 1992, which states that “[a] rule binding upon the parties as a result of the contract does not apply to the extent that, in the given circumstances, this would be unacceptable according to criteria of

10. See BÜRGERLICHES GESETZBUCH [BGB] § 157 (F.R.G.) (Ian S. Forrester et al. trans., 1975) (“Verträge sind so auszulegen, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.”) (“Contracts shall be interpreted according to the requirements of good faith, giving consideration to common usage.”).

11. See CODICE CIVIL [C.C.] art. 1366 (Italy) (Mario Beltramo et al. trans., 1993) (“Il contratto deve essere interpretato secondo buona fede.”) (“The contract shall be interpreted according to good faith.”).

12. See CODE CIVIL [C. CIV.] art. 1134 (Fr.) (John H. Crabb trans., 1977).

13. See CODE CIVIL (Belg.), art. 1134.

14. See NIEUW BURGERLIJK WETBOEK [NBW] art. 6:2, ¶ 1 (Neth.) (Peter Haanappel et al. trans., 1990) (“A creditor and debtor must, as between themselves, act in accordance with the requirements of reasonableness and equity.”); *id.* art. 6:248, ¶ 1 (“A contract has not only the juridical effects agreed to by the parties, but also those which, according to the nature of the contract, result from the law, usage or the requirements of reasonableness and equity.”).

15. See C. CIV. art. 1134 (“Elles [les conventions] doivent être exécutées de bonne foi”) (“[Agreements legally made] must be executed in good faith.”); *id.* art. 1135 (“Les conventions obligent non seulement à ce qui y est exprimé, mais encore à toutes les suites que l’équité, l’usage ou la loi donnent à l’obligation d’après sa nature.”) (“Agreements obligate not only for what is expressed therein, but also for all the consequences which equity, usage or the law gives to an obligation according to its nature.”).

16. See C.C. art. 1375 (“Il contratto deve essere eseguito secondo buona fede”) (“The contract shall be performed according to good faith.”); *id.* art. 1374 (“Il contratto obbliga le parti non solo a quanto è nel medesimo espresso, ma anche a tutte le conseguenze che ne derivano secondo la legge, o, in, mancanza, secondo gli usi e la equità.”) (“A contract binds the parties not only as to what it expressly provides, but also to all the consequences deriving from it by law or, in its absence, according to usage and equity.”).

17. See NBW art 6:2, ¶ 1 (stating that a creditor and debtor must, as between themselves, act in accordance with the requirements of reasonableness and equity); *id.* art. 6:248, ¶ 1 (stating that a contract has not only the juridical effects agreed to by the parties, but also those which, according to the nature of the contract, result from the law, usage or the requirements of reasonableness and equity).

18. On interpretation and good faith in those countries see ASSER & HARTKAMP, STORME, and GHESTIN & BILLIAU, *supra* note 3.

19. See LARENZ, *supra* note 3; TUOR & SCHNYDER, *supra* note 4.

reasonableness and equity.”²⁰ “Reasonableness and equity” are treated by the Code as the equivalent of *good faith and fair dealing*.²¹

In countries other than the Netherlands, the restrictive function of good faith is generally expressed in case law interpreting broad statutory requirements of good faith. For example, the Swiss Code requires all parties to exercise their rights and to perform their duties in accordance with good faith.²² Similarly, the German Code prescribes that a debtor must perform in accordance with good faith, while according to case law the creditor is allowed to rely on his rights to the extent that this would not be contrary to good faith.²³

In Austrian law, the same development has taken place on the basis of Section 914 of the Austrian Civil Code,²⁴ wherein the concept of good faith is not even mentioned. Section 914 merely speaks of the interpretation of a contract in accordance with “die Uebung des redlichen Verkehrs” (“the customs of honest dealings”).²⁵ On the other hand, there has not been such a development in France or Italy, despite similarly broad statutory language.²⁶ In these countries, the restrictive function of good faith has been accepted only in isolated cases, and not as a general principle. In order to achieve the same result as would derive from the

20. See NBW art. 6:248, ¶ 2.

21. For clarity's sake, the NBW reserves the notion of “good faith” for the concept of “good faith purchase.”

22. See SCHWEIZERISCHES ZIVILGESETZBUCH [ZGB] art. 2, ¶ 1 (Switz.) (Ivy Williams trans., 1976) (“Jedermann hat in der Ausübung seiner Rechte und in der Erfüllung seiner Pflichten nach Treu und Glauben zu handeln.”) (“Every person is bound to exercise his rights and fulfill his obligations according to the principles of good faith.”).

23. See BGB § 242 (“Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.”) (“The debtor is bound to effect performance according to the requirements of good faith, giving consideration to common usage.”); LARENZ, *supra* note 3, at 234.

24. ALLEGEMEINES BÜRGERLICHES GESETZBUCH [ABGB] § 914 (Aus.) (Paul L. Baeck trans., 1972).

25. See *id.* (“Bei Auslegung von Verträgen ist nicht an dem buchstäblichen Sinne des Ausdrucks zu haften, sondern die Absicht der Parteien zu erforschen und der Vertrag so zu verstehen, wie es der Uebung des redlichen Verkehrs entspricht.”) (“The interpretation of contracts shall not be based upon the literal meaning of the expressions used but rather upon the true intentions of the parties, and the contract shall be construed in accordance with the customs of honest dealings.”).

26. For France, see GHESTIN & BILLIAU, *supra* note 3, §§ 46-47; GHESTIN, *supra* note 4; ABAS, *supra* note 9, at 43 *et seq.*; M. Hesselink, *De opmars van de goede trouw in het Franse contractenrecht* [The Growing Importance of Good Faith in French Contract Law], 6154 WEEKBLAD VOOR PRIVAATRECHT, NOTARIAAT EN REGISTRATIE [WEEKLY MAGAZINE FOR PRIVATE LAW, NOTARY AND REGISTRATION] 694 *et seq.* (1994). For Italy, see 10-2 R. SACCO, IN TRATTATO DI DIRITTO PRIVATO [TREATISE OF PRIVATE LAW] 456 *et seq.* (1983).

application of the restrictive function, one must show a violation of a stricter standard, to wit, an abuse of rights.²⁷

This brief survey demonstrates that the restrictive function of good faith is rarely expressly accepted by the legislature. Moreover, courts may, but not always do, impose the restrictive function on the basis of blanket statutory language indicating that contracts must be performed in good faith.

I now return to my original query: what is the meaning behind the requirement of Article 1.7 of the UNIDROIT Principles that each party act in accordance with good faith and fair dealing in international trade? The comments to Article 1.7 do not elaborate on the functions of good faith and consequently do not indicate to what extent the functions are covered by the UNIDROIT Principles. However, it may be deduced from the following arguments that all three functions of good faith are covered by the Principles.

First, the illustrations in the comments allude to all three functions.²⁸ Further, the comments to Article 1.7 refer to a number of provisions throughout the UNIDROIT Principles, which either directly or indirectly apply the principles of good faith and fair dealing.²⁹ Among the articles cited by the comments, Articles 4.1 and 4.2 testify to the interpretive function of good faith.³⁰ Regarding the supplementing function, Article 5.2 states that implied obligations may stem from good faith and fair dealing as well as from reasonableness.³¹ Finally, the

27. Hesselink, *supra* note 26, at 694.

28. See UNIDROIT PRINCIPLES, *supra* note 1, art. 1.7 cmts.

29. *Id.*

30. UNIDROIT PRINCIPLES, article 4.1 states:

(1) A contract shall be interpreted according to the common intention of the parties if such an intention can be established.

(2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

UNIDROIT PRINCIPLES, article 4.2 states:

(1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention.

(2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

31. UNIDROIT PRINCIPLES, article 5.2 states:

restrictive function of good faith is evident in Articles 6.2.3 (in case of hardship, the court may terminate or adapt the contract),³² 7.1.6 (unreasonable exemption clauses may not be invoked),³³ and 7.4.13 (a specified sum, stipulated for the case of nonperformance, may be reduced if it is grossly excessive).³⁴

It is unlikely that the drafters of the UNIDROIT Principles intended to limit the restrictive function of good faith to the examples specified therein. Accordingly, the principle of good faith should be available in other circumstances—for instance, to bar a claim based on nonperformance, where the aggrieved party, by its previous conduct, induced the other party to believe that the aggrieved party would not rely on nonperformance as a cause of action. This is a common application of good faith in a number of European countries, including Germany and the Netherlands.³⁵

Implied obligations stem from:

- (a) the nature and purpose of the contract;
- (b) practices established between the parties and usages;
- (c) good faith and fair dealing;
- (d) reasonableness.

32. UNIDROIT PRINCIPLES, article 6.2.3 states:

- (1) In the case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.
- (2) The request for renegotiation does not in itself entitle the disadvantaged party to withhold performance.
- (3) Upon failure to reach agreement within a reasonable time either party may resort to the court.
- (4) If the court finds hardship it may, if reasonable,
 - (a) terminate the contract at a date and on terms to be fixed, or
 - (b) adapt the contract with a view to restoring its equilibrium.

33. UNIDROIT PRINCIPLES, article 7.1.6 states:

A term which limits or excludes one party's liability for non-performance or which permits one party to render performance substantially different from what the other party reasonably expected may not be invoked if it would be grossly unfair to do so, having regard to the purpose of the contract.

34. UNIDROIT PRINCIPLES, article 7.4.13 states:

- (1) Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm.
- (2) However, notwithstanding any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.

35. ASSER & HARTKAMP, *supra* note 3, § 321; LARENZ, *supra* note 3, at 235-36.

The application of the principle of good faith in international commercial contracts does much to ensure satisfactory results. However, the principle must be applied with appropriate restraint. In the field of international commerce, the parties to a contract are usually in a position to settle the terms of their relationship themselves. Consequently, the parties should be able to rely on the terms which they have chosen. Only where such reliance would lead to a clearly unreasonable result (taking into consideration the nature and purpose of the contract and all other relevant circumstances) should a court or an arbitrator step in to supplement, modify, or restrict any of the terms of the agreement. Although such an intervention may be rare, it should not be impossible.