

# Good Faith in English Law— Could a Rule Become a Principle?

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## INTRODUCTION

The research presented in this Paper deals with the evolution of the concept of good faith and the role it plays in English contract law. The alternative hypothesis to be examined here is the influence that the growing imposition of an (explicit) good faith *rule* in specific contractual contexts on the one hand and the *rules* reflecting an underlying good faith principle on the other hand, have on the conception and acceptance of a general good faith *principle*. In other words, this Paper tackles the question of whether the seepage into the English legal system of the rule of good faith through different legal fields has mitigated a deeply rooted reluctance to recognize this principle.

This research question is premised on the oft made distinction between a legal obligation imposed by a rule and a general duty stemming from a larger legal principle. Dworkin's theory set out in his book *Taking Rights Seriously* (1977)<sup>1</sup> can help to establish whether a standard serves as either a 'rule' or a 'principle'.<sup>2</sup>

For the purpose of this analysis, a rule can be defined as an absolute norm that is "*applicable in an all-or-nothing fashion*"<sup>3</sup> although within a restricted context. In other words, it sets out legal consequences that follow when and only if a specific set of preconditions are met. By definition two rules cannot *conflict* with one another. Several rules can *coexist* but only within their respective spheres of application.

A 'principle' is an essential, overarching standard for which lawyers and judges must account because it reflects the basic tenets of morality on which the legal system is based. This fundamental standard must be observed at all times "*because it is a requirement of justice or fairness*"<sup>4</sup>. It is nevertheless possible that two legal principles contradict each other in one legal system. In such cases, the principle that carries more moral weight should supersede the other principle. Here, an appraisal should be based upon thorough consideration of all relevant lines of policy that

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1. R. DWORKIN, *TAKING RIGHTS SERIOUSLY* 371 (Cambridge (MA), Harvard Univ. Press 1977).

2. The distinction between a rule and a principle is not always as clear-cut in practice as it is in the theory set out in Dworkin's book. This ideal-typical division model, however, allows us to largely map out the meaning of good faith in the English legal landscape as it is used and perceived in practice.

3. DWORKIN, *supra* note 1, at 24.

4. *Id.* at 22.

the legal system sets out and, needless to say, will oftentimes stir controversy.

This distinction between a rule and a principle undergirds the basic structure of this text.

In the first Part of this article (I), I examine whether English contract law is familiar with a *principle* of good faith. English legal scholars as well as courts are quite straightforward about the current state of the law in this regard. They mostly voice the opinion that there is no room for a general principle of good faith in English contract law and that English law is not prepared to accept the good faith doctrine as a general principle. I briefly go into this when dealing with the cases of *Walford v. Miles*, *Interfoto v. Stiletto*, and *Petromec v. Petroleo*.

In the next Part (II) I assess those areas of law where the good faith standard acquired the status of a binding *rule*. This second inquiry considers the extent to which a *rule* of good faith sets out boundaries in specific areas of contract law for the principles of binding force and of freedom of contract. This Part focuses on the way in which good faith operates within the confines of consumer law. The implementation of EU Directive 93/13 through the Unfair Terms in Consumer Contracts Regulations of 1994 and 1999 is important here. I then briefly explore the limited and specific application of the good faith-rule under the slightly different set phrase of ‘utmost good faith’. Mention is also made of situations in which parties explicitly opt to subject their contractual obligations to the requirement of good faith.

The first two parts of this Paper focus on *good faith* as either a principle or a rule in English contract law. Under Part (III) I point out the comparable conceptions of English Common Law that could be rationalized as expressions of an underlying principle of good faith. It is here that the principle of good faith might be understood as implicitly providing a conceptual basis for a number of rules that aim at preventing or remedying unfairness. It is indeed worth noting the existence of these functionally equivalent legal conceptions in order to paint a complete picture of how English law accounts for the notion of good faith in its legal tradition.

After exploring the relevant aspects of the current stance of English (positive) contract law on the express or functionally equivalent application of a good faith doctrine, Part (IV) deals with the yet unanswered question of whether the expansion of the good faith idea in different areas of contract law—and not least in consumer law—could influence the way the principle of good faith is generally perceived? This inquiry poses several exciting methodological challenges. Current legal

methodology seems to lack techniques needed to measure the gradual acceptance—if any—of such principle in the legal community. In other words, which research methods might possibly affect a change in outlook on or an attitude about a legal topic when that attitude has yet to have been codified formally in positive law. In an attempt to assess any such alteration in mentality—or at least to discern any change in perception, I have relied on qualitative data regarding scholarly writings.

The Paper then concludes with several core findings and general observations about the role and meaning of good faith in English law.

Before delving into the research questions set out above, I would first like to set this Paper in its larger scientific context. The matter explored here is part of a larger-scale research project concerned with the development of the notion of good faith in the European Union member states after the implementation of the ‘European Directive 93/13 on unfair terms in consumer contracts’. Article 3, 1 of this Directive states that a standard contract term shall be regarded as unfair if “*contrary to the requirement of good faith*” it causes a significant imbalance in the parties’ rights and obligations under the contract, to the detriment of the consumer. This Directive imposes a uniform interpretation of the concept of abusive clauses upon the member states and requires member states to implement this good faith rule into their respective legal systems.

Even though such rule had been previously imposed by the European Union through the adoption of the Agency Directive, it was the implementation of Directive 93/13 that generated so much interest and discussion amongst academics. Indeed, many in the legal community expressed skepticism of the attempt to incorporate the notion of good faith within the European national systems of law.<sup>5</sup> Many critics focused

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5. C. Witz referred to the different understandings of the notion of good faith to illustrate the point that the opponents of a ‘Eurocode’ on private law are making. C. Witz, *Pour un Code européen des obligations*, in B. FAUVARQUE-COSSON & D. MAZEAUD, *PENSÉE JURIDIQUE FRANÇAISE ET HARMONISATION EUROPÉENNE DU DROIT* 152-53 (Paris, Société de Législation Comparée 2003); see also M. Hoch, *Is Fair Dealing a Workable Concept for European Contract Law?*, 5 *GLOBAL JURIST TOPICS* (2005); A.M. Lopez-Rodriguez, *Towards a European Legal Code Without a Common European Legal Culture? The Link Between Law, Language and Culture*, 29 *BROOKLYN J. INT’L L.* 1203-04 (2004); P. Nebbia, *Unfair Terms in Consumer Contracts: An Anglo-Italian Comparison*, in M. VAN HOECKE & F. OST, *THE HARMONIZATION OF EUROPEAN PRIVATE LAW* 179-88 (Oregon (Portland), Hart Publ’g 2000); G. Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences—Legal Transplant: A Misleading Metaphor*, 61 *MODERN L. REV.* 11-32 (1998); P. Legrand, *The Impossibility of Legal Transplants*, 4 *MAASTRICHT J. EUR. & COMP. L.* 111-24 (1997); J.E. O’CONNOR, *GOOD FAITH IN ENGLISH LAW* 148 (Aldershot, Dartmouth Publ’g Co. 1989); S. Whittaker, *Assessing the Fairness of Contract Terms: The Parties’ ‘Essential Bargain’, Its Regulatory Context and the Significance of the Requirement of Good Faith*, *ZEITSCHRIFT FÜR EUROPÄISCHES RECHT* 75-98 (2004).

on the structural differences in legal cultures within Europe. A number of scholars pointed out that England's notion of good faith differs fundamentally from the notion of good faith commonly held on the 'continent'.<sup>6</sup> This Paper, in fact, will demonstrate that English law always rejected a general application of a good faith principle, though it has offered a rather "*piecemeal*"—but from a functional perspective a *prima facie* equivalent—approach.<sup>7</sup> Good faith is generally considered a typical Civil Law-concept. Moreover, even amongst Civil Law countries there is divergence regarding the scope and application of the good faith principle.<sup>8</sup> Some, therefore, argued that any endeavor to harmonize this concept would be futile and unwelcome.<sup>9</sup> Others, however, suggest that the good faith principle does not necessarily have to be a "*legal irritant*" to Common Law, and could even create an opportunity for constructing a more consistent approach.<sup>10</sup>

Several recent studies have assessed the extent to which a number of countries have adapted their legislation to comply *formally* with the Directive's requirements.<sup>11</sup> No study, however, has examined how article 3, 1 of the Directive influenced the current understanding and development of the notion of good faith in the *actual legal practice* of these European Union member states. English law offers an interesting starting point for this research. One of the underlying matters this Paper will address is the impact the introduction of the concept of good faith in Directive 93/13 has had on the application and content of good faith by both English legal practitioners and courts, *beyond* the sphere of application of the Directive.

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6. See on the comparison of this notion in Europe: R. Zimmermann & S. Whittaker (eds.), *GOOD FAITH IN EUROPEAN CONTRACT LAW* 720 (Cambridge, Cambridge Univ. Press 2000) [hereinafter Zimmermann & Whittaker].

7. O'CONNOR, *supra* note 5, at 17-49.

8. J. Smits, *Toward a Multi-Layered Contract Law for Europe*, in S. Grundmann & J. Stuyck (eds.), *AN ACADEMIC GREEN PAPER ON EUROPEAN CONTRACT LAW* 387-98 (Den Haag, Kluwer Law Int'l 2002) [hereinafter Grundmann & Stuyck]; O'CONNOR, *supra* note 5, at 81-98; A.M. Musy, "The good faith principle in contract law and the precontractual duty to disclose: comparative analysis of new differences in legal cultures", *Global Jurist Advances* 2001, 1(1), 1-21.

9. See, e.g., Smits, *supra* note 8, at 387-98.

10. R. Zimmermann, *Roman Law and European Legal Unity*, in A. Hartkamp et al. (eds.), *TOWARDS A EUROPEAN CIVIL CODE 22 et seq.* (Den Haag, Kluwer Law Int'l 2004).

11. H. Schulte-Nölke (ed.), *EC Consumer Law Compendium—Comparative Analysis*, EUROPEAN UNION (Apr. 2007), [http://ec.europa.eu/consumers/cons\\_int/safe\\_shop/acquis/comp\\_analysis\\_en.pdf](http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf); Report from the Commission on the Implementation of Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, Brussels 27 April 2000, COM (2000) 248 final.

The criticism surrounding the adoption of European Directive 93/13 and the implementation of good faith in the domestic legal systems echoes the debate on establishing or defining a European *ius commune*. Comparative legal scholarship in Europe is frequently concerned with the harmonization/unification/codification<sup>12</sup> of private law at a European level or—as some call it—the “*europeanisation*”<sup>13</sup> or even “*re-europeanisation of private law*”<sup>14</sup>. Numerous questions have been raised and quite a few points of view set forth regarding the feasibility<sup>15</sup>, value, acceptability<sup>16</sup>, and methodology<sup>17</sup> of the enterprise to establish a coherent *ius commune*.<sup>18</sup> The several projects that have explored these matters in some depth have tended to be academically rather than politically driven endeavors. Examples of these are the Principles of European Contract Law (PECL) that were drafted by the ‘Lando Commission’<sup>19</sup>, or the more

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12. Osman and Jeammaud pointed out the subtle distinction that exists between these different notions. F. Osman, *Codification, unification, harmonization du droit en Europe: un rêve en passe de devenir réalité?*, and A. Jeammaud, *Unification, uniformisation, harmonization: de quoi s’agit-il?*, in F. Osman (ed.), *VERS UN CODE EUROPÉEN DE LA CONSOMMATION* 11-55 (Brussels, Bruylant 1998).

13. About the different meanings attributed to this term, see G. FALKNER, O. TREIB ET AL., *COMPLYING WITH EUROPE—EU HARMONIZATION AND SOFT LAW IN MEMBER STATES* 11 (Cambridge, Cambridge Univ. Press 2005).

14. R. Zimmermann, *Roman Law and the Harmonization of Private Law in Europe, in TOWARDS A EUROPEAN CIVIL CODE*, *supra* note 10, at 24.

15. This was one of the main themes in the book *TOWARDS A EUROPEAN CIVIL CODE*, *supra* note 10, at 847.

16. Kenny stated that “*imposing a uniform law on Europe is a task outside even the most functional reading of the remit provided by the Treaty to complete the internal market.*” M. KENNY, *CONSTRUCTING A EUROPEAN CIVIL CODE: QUIS CUSTODIET IPSOS CUSTODIES* 3 (Bremen, ZERP 2006). On this question, see also S. Vogenauer & S. Weatherill, *The European Community’s Competence To Pursue the Harmonization of Contract Law—An Empirical Contribution to the Debate*, in S. Vogenauer & S. Weatherill (eds.), *THE HARMONIZATION OF EUROPEAN CONTRACT LAW—IMPLICATIONS FOR EUROPEAN PRIVATE LAWS, BUSINESS AND LEGAL PRACTICE* 105-48 (Oxford & Portland (Oregon), Hart Publ’g 2006) [hereinafter Vogenauer & Weatherill].

17. Depending on whether the goal is set to establish a ‘droit pluraliste’ or a ‘droit commun’, different instruments are more appropriate than others. Directives and recommendations are more apt to promote an approximation of laws whilst respecting the existing national legal cultures, whereas a code would aim to more vigorously eliminate differences in national laws. C. Jamin, *Droit européen des contrats*, in FAUVARQUE-COSSON & MAZEAUD, *supra* note 5, at 161-80.

18. On this debate, see for instance: S. Weatherill, *Why Object to the Harmonization of Private Law by the EC*, 5 *EUR. REV. PRIV. L.* 663-60 (2004). Some scholars question the feasibility and value of the Europeanization of private law (see, e.g., Pierre Legrand, *A Diabolical Idea, in TOWARDS A EUROPEAN CIVIL CODE*, *supra* note 10, at 245-70) or clearly state the case against a formal code (See, e.g., M.J. Bonell, *The Need and Possibilities of a Codified European Contract Law*, 1997 *EUR. REV. PRIV. L.* 505). Also adding to this debate are the authors contributing to the book that came about under the editorship of Fauvarque-Cosson & Mazeaud, *supra* note 5, at 303.

19. The ‘Commission on European Contract Law’ that is chaired by Ole Lando intended to create a homogeneous codification of European private law and this in the tradition of A.F.J.

recent formulation of a Common Frame of Reference<sup>20</sup>. The European Union commissions research and drafting projects that expressly seek to overcome the disparity between European domestic laws.<sup>21</sup> The European Union legislative process itself has consciously sought to unify European private law and has done so principally through its Directives. All these initiatives first and foremost aspire more to achieve a convergence of national *rules* of law, then to establish common legal principles as such.<sup>22</sup>

These projects are inspired by the notion that the harmonization of European national laws will contribute to the political goal of achieving a more efficient common market<sup>23</sup> and a more compact political community.<sup>24</sup> The ‘*acquis communautaire*’, however, provides a natural starting point for understanding the origins and basic structure of the greater project. A significant body of existing private law is derived from

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Thibaut. Its Web site is to be found at [http://frontpage.cbs.dk/law/commission\\_on\\_european\\_contract\\_law](http://frontpage.cbs.dk/law/commission_on_european_contract_law).

20. The Study Group on a European Civil Code presided by Christian von Bar is a network of academics whose aim is to produce a set of principles of European Law that is referred to as the Common Frame of Reference. Its official Web site is to be found at <http://www.sgecc.net>. Another important study group that contributed to the Draft CFR, is the ‘Acquis Group’ or the ‘Research Group of the Existing EC Contract Law’. For more information, see their Web site at <http://www.acquis-group.org>.

21. An interesting example here is the European Commission’s Draft Directive on Consumer Rights that attempts to merge four existing directives into one. The four directives are: Unfair Contract Terms Directive (93/13); the Directive on the Sale of Consumer Goods and Guarantees (99/44); the Distance Selling Directive (97/7); the Doorstep Selling Directive (85/577). The proposal aims for full maximum harmonization. For a discussion of this draft proposal, see R. Massey, *Legislative Comment Sales for the Next Century: Europe’s Draft Directive on Consumer Rights*, 15 *COMPUTER & TELECOMM. L. REV.* 23-25 (2009).

22. This was rightfully pointed out by W. Van Gerven, in *About Rules and Principles, Codification and Legislation, Harmonization and Convergence, and Education in the Area of Contract Law*, in A. Arnulf et al. (eds.), *CONTINUITY AND CHANGE IN EU LAW—ESSAYS IN HONOUR OF SIR FRANCIS JACOBS* 400 et seq. (Oxford, Oxford Univ. Press 2008).

23. Ole Lando stated in his book on the *Principles of European Contract Law* that the idea for such a project sprung from the concern that uniform substantive rules were needed to establish the “*legal uniformity necessary for an integrated European market*” and that mere choice of law rules (as they were proposed at the 1974 symposium at the Copenhagen Business School) would be insufficient. O. Lando & H. Beale (eds.), *PRINCIPLES OF EUROPEAN CONTRACT LAW*, Parts I and II, preface (The Hague, Kluwer Law Int’l 2003). S. Weatherill pointed out that various harmonizing directives commonly justify their existence by explaining that the variation between national laws impedes market integration and therefore prompted a need for harmonization at Community level. S. Weatherill, *Maximum or Minimum Harmonization—What Kind of Europe Do We Want?*, in K. Boele-Woelki & W. Grosheide (eds.), *THE FUTURE OF EUROPEAN CONTRACT LAW* 134 (The Hague, Kluwer Law Int’l 2007). On the arguments *pro* and *contra* harmonization of European contract law, see also E. McKendrick, *Harmonisation of European Contract Law: The State We Are In*, in Vogenauer & Weatherill, *supra* note 16, at 5-29.

24. This was clearly set out in the Single European Act of 1987, OJ L 169 of 29 June 1987.

the idea of consumer protection.<sup>25</sup> Indeed EU member states agreed to implement a (initially)<sup>26</sup> minimal standard of consumer protection in their respective national legislations.<sup>27</sup> The questions raised in this regard closely relate to the research presented in this article.

#### I. ENGLISH LAW TRADITIONALLY DOES NOT ACCEPT A PRINCIPLE OF GOOD FAITH

English courts seem to resist the application of a *general* principle that parties should act in good faith in concluding and performing contracts. The House of Lords iterated this position in the landmark case of *Walford v. Miles*. This decision was confirmed in a series of later decisions.

##### A. *Rationale*

Several underlying reasons help explain the objection to applying a general duty of good faith.

The first explanation is deeply rooted in English contract law and its traditional foundation in an individualistic ethic. This tradition implies that contractors will pursue their own (one-sided) economic interests and are under no obligation to concern themselves with other party's

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25. On European Community action with regard to consumer protection, see, for instance: P. NEBBIA & T. ASKHAM, *EU CONSUMER LAW* 316 (Richmond, Richmond Law & Tax Ltd. 2004); C. Castronovo, *Common Frame of Reference and Acquis—Conciliation or Clash?*, in *THE FUTURE OF EUROPEAN CONTRACT LAW*, *supra* note 23, at 160-61.

26. S. Weatherill pointed at the recent tendency of the Commission to favor full or maximum harmonization instead of the minimum harmonization envisaged by article 153 and 95 EC Treaty. Weatherill, *supra* note 23, at 137-38.

27. The consumer protection measures were equally infused by the goals the European Community set out for itself:

*by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, [ . . . ] promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.*

Article 2 of the Consolidated Version of the Treaty Establishing the European Community. F. Picod rightfully observed that “*tels fondements très généraux (...) permettaient a priori de justifier toute action de la Communauté*”. F. Picod, *Les fondements juridiques de la politique communautaire de protection des consommateurs*, in *VERS UN CODE EUROPÉEN DE LA CONSOMMATION*, *supra* note 12, at 73.



interests.<sup>28</sup> Parties are under no legal obligation to cooperate within the framework of this adversarial model. On the contrary, one can assume that each party will endeavor to pursue only their narrow interests in the contractual process. This practice conforms to the principle of freedom of contract according to which the parties freely and voluntarily enter into any contract they like and do so—at least in principle—without regard for its inherent fairness or social desirability.<sup>29</sup> These ideas, of course, run contrary to the idea of cooperativism that is said to undergird the general notion of good faith in European (continental) contract law. An absolute adherence to the idea of market-individualism and an extreme observance of the principle of freedom of contract would also be out of touch with economic reality.<sup>30</sup> We see that neither courts nor the legislatures strictly subscribe to these ideas. On the contrary, they defer to arguments of fairness in their assessment of contractual relations. Although the English courts clearly shun a ‘social justice’ debate, they barely recognize that in some circumstances there should be rectifying mechanisms that, at the very least, could be engaged on a case-by-case basis.<sup>31</sup> Averse to any general application of an evasive standard, modern<sup>32</sup> English law accepts piecemeal exceptions to the thesis of market-individualism, which, in turn, implies that the interests of others can indeed be taken into account. These particular rules—discussed

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28. This is said to promote market efficiency: a party who does not have to concern himself with the interest of the other party can focus on discovering what the most rational bargain is for him.

29. H. Beale (ed.), *CHITTY ON CONTRACTS* 1-011 (29th ed., London, Sweet & Maxwell 2004) [hereinafter Beale]; E. PEEL, *THE LAW OF CONTRACT* 2-3 (12 ed., London, Sweet & Maxwell 2007); E. Treitel, *Contact: In general*, in A. Burrows (ed.), *ENGLISH PRIVATE LAW* 624-25 (Oxford, Oxford Univ. Press 2007); E. MCKENDRICK, *CONTRACT LAW* 3-5 (7th ed., Hampshire, Palgrave MacMillan 2007).

30. The theory of freedom of contract is premised on the idea that the parties are autonomous agents with a free will and an equal capacity to enter into contracts. This is, however, not always consistent with the economic reality. Think of for instance the erosion of the competitive market through monopolistic enterprises. Moreover, some strongly oppose the tenet that the behavior of economic agents can be caught in a scheme that is primarily based on rationality. On behavioral economics and its application in the field of comparative law, see J. de Coninck, *Overcoming the Mere Heuristic Aspirations of (Functional) Comparative Legal Research? An Exploration into the Possibilities and Limits of Behavioral Economics*, *GLOBAL JURIST* 2009, Vol. 9, Iss. 4 (Topics), art. 3.

31. Collins pointed out that the lack of such mechanisms might cause obstruction to the operation of a competitive market. H. COLLINS, *THE LAW OF CONTRACT* 182 (Cambridge, Cambridge Univ. Press 2003).

32. The old Common Law judges were much harsher in consistently applying the individualistic model. Cases are reported where a seller gets the green light to enforce a transaction that was fraudulently obtained. The idea was that “*life in the business world is rough and tough and you should not get into it if you do not know what you are doing*”. R. GOODE, *THE CONCEPT OF ‘GOOD FAITH’ IN ENGLISH LAW* 4 (Rome, UNIDROIT 1992).

under title 2—reduce the rigor of the *caveat emptor* tenet and discourage an overly strict application of the will theory.

The English courts, moreover, have been persistently reluctant to apply any kind of general principle of fairness.<sup>33</sup> The English propensity to reject the use of general principles such as good faith is replicated in case law in which, once again the construction and use of *other* general theories is rejected.<sup>34</sup> An example is the controversy regarding the appellate decision of *Lloyds Bank v. Bundy* from 1974 in which Lord Denning attempted to introduce a general doctrine of inequality of bargaining power. He explicitly stated this objective as follows:

There are cases in our books in which the courts will set aside a contract, or a transfer of property, when the parties have not met on equal terms—when the one is so strong in bargaining power and the other so weak—that, as a matter of common fairness, it is not right that the strong should be allowed to push the weak to the wall. Hitherto those exceptional cases have been treated each as a separate category in itself. But I think the time has come when *we should seek to find a principle to unite them*<sup>35</sup> (. . .) Gathering all together, I would suggest that through all these instances there runs a single thread. They rest on ‘inequality of bargaining power’.<sup>36</sup>

The House of Lords vehemently rejected this approach.<sup>37</sup> In *National Westminster Bank v. Morgan* the House of Lords disapproved of the dictum of Lord Denning in the *Lloyds Bank* case. Discussing the way in which Lord Denning attempted to reconcile various strands of the law under the heading ‘inequality of bargaining power’, Lord Scarman stated:

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33. Collins rightfully pointed out that courts tend to proceed by reference to narrower doctrines or rules that have a similar effect as the good faith rule in Civil Law countries. COLLINS, *supra* note 31, at 181. Some of these rules will be set under title 3. Mason referred to a string of cases in which Lord Bingham keeps harping on the usefulness of moving towards a general principle. The cases referred to by Mason were *Philips Electronic Grand Public SA v. BSB*, [1995] E.M.L.R. 472; *Balfour Beatty v. DLR*, [1996] 78 B.L.R. 42; *Timeload Ltd v. British Telecom*, [1995] E.M.L.R. 459. These attempts did, however, not have a lot of impact. J. Mason, *Contracting in Good Faith—Giving the Parties What They Want*, 23 CONSTRUCTION L.J. 441 (2007).

34. R. STONE, *THE MODERN LAW OF CONTRACT* 24 (London & N.Y., Routledge-Cavendish 2007); Beale, *supra* note 29, at 1-020.

35. Emphasis added.

36. *Lloyds Bank v Bundy*, [1975] Q.B. 326, 339-40.

37. I did, however, find a couple of English cases in which the theory of inequality of bargaining power was considered as a valid doctrine. One decision was rendered by Lord Denning himself: *Clifford Davis Management Ltd. v WEA Records Ltd.*, [1975] 1 W.L.R. 61, 66. Another English decision in which the court decided against the presence of an inequality of bargaining power between plaintiff and defendant was *Horry v. Tate & Lyle Refineries Ltd.*, [1982] 2 Lloyd's Rep. 416.

Such a reconciliation is not justified, nor is it either necessary or desirable. It causes the court to embark on a task of assessing fairness for which it is ill-equipped, overlooks the value of the different elements that rightly have been held on highest authority to be the basis of relief in cases of duress, salvage agreements, unconscionable bargains and other cases that Lord Denning seeks to amalgamate and attempts a task that, if it is to be attempted at all, is more appropriate for the legislature with the assistance of the Law Commission.<sup>38</sup>

Further on, he added, “*And even in the field of contract I question whether there is any need in the modern law to erect a general principle of relief against inequality of bargaining power.*”<sup>39</sup> Yet, one can hardly deny that the parties’ unequal bargaining positions do play a role in the courts’ assessment of the validity of certain clauses, especially in consumer matters. This is also supported by legislative policies that protect against unfair practices in business-to-consumer relationships.<sup>40</sup>

A third possible explanation is closely related to the previous reason: English contract law promotes legal certainty and predictability. As a general rule the reasonable expectations of the parties should prevail and be protected.<sup>41</sup> English courts, however, hold the view that a good faith obligation cannot be defined and is thus too ambiguous to be enforced.<sup>42</sup> This is in line with its acceptance of an objective theory of contract which claims to establish the intention from the ascertainable and objective dealings of the parties.<sup>43</sup> This substantive legal theory, moreover, reveals itself in the courts’ preference to defer strictly and literally to the contract terms rather than to submit the contract terms to a teleological method of interpretation.<sup>44</sup>

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38. Nat’l Westminster Bank Plc v. Morgan, [1985] A.C. 686, 692.

39. *Id.* at 707.

40. S. Brown, The Consumer Credit Act 2006: Real Additional Mortgagor Protection, CONVEYANCER & PROP. LAW. 333-34 (2007).

41. First Energy (UK) Ltd. v Hungarian Int’l Bank Ltd., [1993] 2 Lloyd’s Rep. 194, 196. On the importance of the notion of ‘reasonable expectations’ in contract law, see C. Mitchell, *Leading a Life of Its Own? The Roles of Reasonable Expectation in Contract Law*, 23 OXFORD J. LEGAL STUD. 639-65 (2003).

42. COLLINS, *supra* note 31, at 181; E. McKendrick, *The Meaning of ‘Good Faith’, in LIBER AMICORUM GUIDO ALPA 691* (Surrey, British Inst. of Int’l & Comp. L. 2007).

43. For a refinement of the meaning of the theory of objectivity in contract law, see MCKENDRICK, *supra* note 29, at 26.

44. The House of Lords, however, held that the judges are allowed to consult Hansard (which is a collection of the printed transcripts of parliamentary debates) in interpreting in construing legislation. *Pepper v. Hart*, [1993] A.C. 593. Lord Oliver of Aylmerton expressed in the case of *Pepper v. Hart* that there is “*both the room and the necessity for a limited relaxation of the previously well-settled rule which excludes reference to Parliamentary history as an aid to statutory construction.*” He added that opening this door should happen under certain restrictions. He stated: “*It can apply only where the expression of the legislative intention is genuinely*

*B. Walford v. Miles and the Implied Duty of Good Faith*

The reasons pointed out in the above reflect some of the arguments on which the House of Lords based its decision in the case of *Walford v. Miles*.<sup>45</sup> This landmark case confirmed the traditional position that there is no room in English contract law for an overriding principle of good faith.

The dispute behind this case concerned a ‘lock-out agreement’<sup>46</sup> between the seller of a property (Miles) and a potential buyer (Walford). The parties had in principle agreed that Miles would sell his property to Walford for GBP 2 million. Walford promised to provide Miles with a letter of comfort from his bank in which the latter confirmed the loan facilities to raise this amount of money. Miles had assured that it would “*not treat with any third party or consider any other alternative offers*” if Walford provided him with such document. Walford kept his promise and provided the letter. Miles, however, withdrew from negotiations and concluded a sales agreement with a third party. Miles’ counsel informed Walford of this decision by letter.

Walford treated this letter as a repudiation of a lock-out agreement and filed an action for damages. The judge dealing with this case in first instance found that there was a collateral agreement whereby Miles undertook not to negotiate with third parties. That agreement, however, had been repudiated. The Court of Appeals held that such an agreement was no more than an agreement to negotiate and was therefore unenforceable. The House of Lords equally decided that a simple agreement to negotiate, which failed to specify the time during which the seller was expected not to negotiate with third parties, was unenforceable simply because it lacked the essential quality of certainty. In the instant case there was uncertainty about the termination of the negotiations. The lock-out agreement in the instant case was invalid because it did not specify how long the seller’s obligation would last. This deficiency could

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*ambiguous or obscure or where a literal or prima facie construction leads to a manifest absurdity and where the difficulty can be resolved by a clear statement directed to the matter in issue.”* *Id.* at 620. On interpretation of English statutes, see also: J. Bell, *Sources of Law*, in A. Burrows (ed.), ENGLISH PRIVATE LAW 15-29 (Oxford, Oxford Univ. Press 2007); SIR R. CROSS ET AL., STATUTORY INTERPRETATION 49-164 (3d ed., London-Dublin-Edinburgh, Butterworths 1995).

45. *Walford v. Miles*, [1992] 2 A.C. 128. For a discussion of this case, see: A. Berg, *Promises To Negotiate in Good Faith*, 119 LAW Q. REV. 357-63 (2003); P. Neill, *A Key To Lock-Out Agreements*, 108 LAW Q. REV. 405-13 (1992); S. Hermes, *Locked out by the court of appeal*, 12 COMPANY LAW. 50-53 (1991); I. Brown, *The Contract To Negotiate: A Thing Writ in Water*, 1992 J. BUS. L. 353-68.

46. This is an agreement that forbids either or one party to seek or engage approaches from third parties. This is different from a lock-in agreement where the parties agree to exclusively negotiate with one another.

not be rectified by arguing that this duty should endure “*for such time as is reasonable in all the circumstances*” as suggested by Lord Bingham in the Court of Appeal.<sup>47</sup> Lord Ackner asked how a party is supposed to know when he/she is entitled to withdraw from further negotiations. Invariably a party to such agreement never knew exactly how the court would police such an agreement. The suggested solution consisted in using a subjective standard and evaluating this standard by answering the question of whether the parties conducted the negotiations “*in good faith*”. This gave the House of Lords the opportunity to elaborate on the duty of good faith and on why it is an unacceptable standard under English law. Lord Ackner objected to this line of reasoning on the ground that such good faith-standard “*is inherently repugnant to the adversarial position of the parties when involved in negotiations*”.<sup>48</sup> A party should always be entitled to withdraw from the negotiations if he determines that it is appropriate to advance his own interests. A second objection to the use of this standard is that it is difficult for a party to know when he may withdraw from further negotiation and for a court to police these agreements. The obligation to negotiate in good faith is not only inconsistent with the position of the negotiating party, it is unworkable in practice as well. Lord Ackner, therefore, refused to imply a term into the contract that the parties agreed to act in good faith until they had found themselves unable to come to mutually acceptable terms.

The House of Lords in the Walford case refused to accept an implied duty of good faith in contract law, and more specifically an agreement to negotiate. This arose out of traditional hostility to the use of ‘good faith’ in English contract law. Many courts reiterated this stance in subsequent decisions.<sup>49</sup> However, it seems that the case for or against good faith as a general principle is not as clear as Walford would have us believe. At times, the principle of good faith has provided a platform for arguing in favor of a general duty of fairness in contract law.

### C. *Interfoto v. Stiletto and Fair and Open Dealing*

A case that is traditionally referred to in this regard is the Court of Appeal’s decision of *Interfoto Picture Library Ltd. v. Stiletto Visual*

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47. Walford v. Miles, [1991] 62 P. & C.R. 410, 421.

48. Walford v. Miles, [1992] 2 A.C. 128, 138.

49. See, e.g., *Ultraframe v. Tailored Roofing*, [2004] 2 All. E.R. (Comm) 692 (“*Nor is it possible by using rather general language such as ‘acting in good faith’ to construct a term which may make the conduct during one period of the contract lawful, but during another unlawful. (. . . ) the need to use words such as (. . . ) or ‘good faith’, all of which would in any event give rise to serious problems when considering what was or was not a breach, demonstrate that the framing of the term desired was itself so difficult as to make implication impossible.*”).

*Programmes Ltd.*<sup>50</sup> This 1987 case dealt with the legal question of whether a party seeking to enforce a particularly onerous or unusual condition in a contract, had to prove that this clause had been fairly and reasonably brought to the attention of the other party. The Court concluded that the clause in question had not become part of the contract and was therefore not enforceable, since the plaintiffs in the case had done nothing to bring this to the attention of the defendants. Essential to the Court's ruling were the principles of fairness and reasonability. On the basis of these principles, the Court ruled that there had been insufficient notice and that therefore the contract was unenforceable.

In his argument Lord Justice Bingham suggested that in Civil Law systems there is an “*overriding principle that in making and carrying out contracts parties should act in good faith*”. He stated that this in essence referred to a “*principle of fair and open dealing*” and used other explanatory idioms such as “*playing fair*”, “*coming clean*” or “*putting one's cards face upwards on the table*”. The principle of good faith is thus more far reaching than the simple requirement that parties should not deceive each other, the latter being a general duty “*which any legal system must recognize*”. Lord Bingham also suggested that the English law had *not* committed itself to any such overriding principle but had “*developed piecemeal solutions in response to demonstrated problems of unfairness*”. He pointed to a range of solutions that can be found in Equity and Common Law as written by the legislature. In his view, the cases on “*sufficiency of notice*” should be read in this context.<sup>51</sup>

#### D. *Petromec v. Petrolea and an Express Duty of Good Faith*

Another remarkable event is the more recent case of *Petromec Inc. v. Petroleo Brasileiro SA Petrobas*<sup>52</sup> in which a general duty to act in good

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50. *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.*, [1989] Q.B. 433 (CA (Civ. Div.)). For a discussion of this case, see E. MacDonald, *The Duty To Give Notice of Unusual Contract Terms*, 1988 J. BUS. L. 375-85; J.A. Holland & P.A. Chandler, *Notice of Contractual Terms*, 104 LAW Q. REV. 359-62 (1988).

51. *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.*, [1989] Q.B. 433, 439 (CA (Civ. Div.)). Lord Bingham, moreover, also in later decisions made such references and expressed a certain interest in an application of the good faith principle in contract law. In for instance *Balfour Beatty Civil Engineering Ltd. v. Docklands Light Railway Ltd.*, [1996] C.L.C. 1435, 1442 (CA (Civ. Div.)), he stated: “*We would then have wished to consider whether an employer, invested (albeit by contract) with the power to rule on his own and a contractor's rights and obligations, was not subject to a duty of good faith substantially more demanding than that customarily recognised in English contract law.*”

52. *Petromec Inc. Petro-Deep Societa Armamento Navi Appoggio SpA v. Petroleo Brasileiro SA*, [2006] 1 Lloyd's Rep. 121.

faith has been more clearly promoted.<sup>53</sup> The case concerned an agreement for the upgrade of an oil rig vessel to render it suitable for employment on the South Marlim oil field. When it became apparent that the vessel would be more useful in the Roncador oil field, the parties agreed that—instead of reformulating the original contractual documentation—their contract would be corrected by an amending agreement. Under the agreement Brasoil agreed to pay to Petromec an amount equal to the reasonable extra cost of upgrading the vessel according to the amended requirements. In clause 12.4. Brasoil agreed to “*negotiate in good faith with Petromec the extra costs*” for the alterations.

This case is particularly interesting since the Court seemed to suggest that the House of Lords might reconsider *Walford v. Miles* (since: “*That is not an option open to this court*”)<sup>54</sup>. By distinguishing it from the Walford case, the Court refined the rule that rejects a general application of a principle of good faith. It did so—albeit *obiter*—when it dealt with the question of whether an *express* obligation to negotiate in good faith was enforceable. The Court reasoned in favor of the enforceability of the obligation to negotiate in good faith that was *expressly* provided for in an *existing* contract.

Elaborating on this line of thought, the Court justified its deviation from the precedent of the House of Lords by clearly distinguishing the instant case from the facts leading up to the Walford ruling. It was Lord Justice Longmore who found it necessary to expound on whether the traditional objections to enforcing an obligation to negotiate in good faith held water in the instant case. He, firstly, set out the three objections that are traditionally made in underpinning the theory of unenforceability of an obligation to negotiate in good faith. After waving aside two traditional objections, he acknowledged that it is indeed difficult to say whether the termination of negotiations is brought about in good or in bad faith. He stated that “*the concept of bringing negotiations to an end in bad faith is somewhat elusive*”<sup>55</sup>. However, he went on to say that a mere difficulty is not an excuse for a court to withhold relevant assistance and that the court has a duty to consider the reasons why the negotiations were terminated. Secondly, Lord Justice Longmore referred to the case of *Walford v. Miles* stating that it “*(of course) binds us for what it decides*”<sup>56</sup>. But he immediately concluded that the facts of

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53. For a discussion of this case, see McKendrick, *supra* note 42, at 687-98.

54. *Petromec v. Petroleo*, [2006] 1 Lloyd's Rep. at 154.

55. *Id.* at 153.

56. *Id.*

Walford differed from the case presented before him. In the Walford case, there was no concluded agreement since everything was “*subject to contract*”<sup>57</sup>. Another distinction was that in Walford there was no *express* agreement to negotiate in good faith, and therefore the lock-out agreement was too uncertain to be enforceable. In the *Petromec* case, there was no agreement to negotiate but rather an obligation that was part of an already existing complex agreement that was drawn up “*under the imprint of*”<sup>58</sup> a highly qualified law firm. The parties had deliberately and expressly entered into the agreement implied by the clause. It could hardly be upheld that the express obligation to negotiate as contained in clause 12.4. was completely without legal substance. Not upholding the clause would amount to defeating “*the reasonable expectations of honest men*”<sup>59</sup>.

#### E. *Some Critical Reflections*

Although *Walford v. Miles* remains good law, it seems that it provided an opening to allow the insertion of a general obligation to negotiate in good faith into a contract. This was only permitted, however, when the parties *expressly* assumed such an obligation in their contract. The traditional argument regarding the encroachment upon the parties’ freedom of contract hardly stands up to scrutiny in case of an express agreement.

One might, however, speculate whether the argument of a “*lack of necessary certainty*”<sup>60</sup> as set forth by Lord Ackner in the Walford case does not equally apply to an implied good faith obligation and to an expressly agreed commitment to negotiate in good faith.<sup>61</sup> The question is whether it be more obvious for a court to police an express good faith obligation rather than one that stems from an implied term? The House of Lords has not had a chance to rule on this question.

In this regard it is interesting to mention the reasoning of Lord Ackner in the Walford case about the haziness of a good faith standard. He obliquely points out that the argument of uncertainty “*does not apply to an agreement to use best endeavours*” but fails to elaborate adequately on this statement. This leaves us to wonder whether the standard of ‘reasonable’ or ‘best endeavours’ does not require an appraisal of a party’s due withdrawal from negotiations that is equally as delicate and

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57. *Id.*

58. *Id.*

59. *Id.*

60. *Walford v. Miles*, [1992] 2 A.C. 128, 138.

61. McKendrick, *supra* note 42, at 691.



subjective as the assessment of a breach of a promise to negotiate in good faith.<sup>62</sup> Peel explains this distinction by interpreting the use of ‘best endeavours’ as referring to “*the machinery of negotiation*”,<sup>63</sup> while ‘good faith’ relates to the substance of the positions taken during negotiations. Promises about the latter can be less easily enforced. It is easier to give a precise content to the obligation of a party to for instance “*make himself available for negotiations*”.<sup>64</sup> A similar reasoning seemed to persuade the High Court of Justice in the case of *BBC Worldwide Ltd. v. Bee Load Ltd.*<sup>65</sup> to decide on the unenforceability of an agreement to discuss *in good faith* an extension of a time frame during which certain obligations needed to be observed. The High Court distinguished from the *Petromec* ruling on the basis of the argument that the agreement to negotiate in good faith in the latter case was simply a “*matter of machinery for quantifying*” the substantive obligation on the part of Brasileiro to pay Petromec’s reasonable costs. In the *Petromec* case, the cost was reasonably easy to ascertain. The High Court decided that this was precisely the point at which the *Petromec* case differed from the case at hand. The good faith clause in the BBC case could “*not be regarded as machinery for determining the amount of a contractual liability. The clause provides no criteria by which a court could determine whether ‘in good faith’ any particular request for any particular form of extension should be considered favourably*”.<sup>66</sup>

## II. ENGLISH LAW AND THE APPLICATION OF A GOOD FAITH RULE

### A. Contextual or ‘Piecemeal’ Approach

Good faith as a ‘notion’ or ‘concept’ is definitely not alien to English law. Historically it was part of the mercantile customary law. Commonly accepted commercial practice required merchants to act in good faith.<sup>67</sup> Lord Mansfield phrased this famously in the case of *Carter v. Boehm*, where he held: “*The governing principle is applicable to all contracts and dealings. Good faith forbids either party from concealing*

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62. See on this point also Neill, *supra* note 45, at 410.

63. On the use of ‘best endeavours’ clauses, see, for example, T. Marino, “*Best Endeavours*” *Clauses in Entertainment Industry Contracts*, 20 ENT. L. REV. 134-38 (2009).

64. PEEL, *supra* note 29, at 66-67. McKendrick also linked up the good faith obligation with the requirement to use ‘best endeavours’, ‘all reasonable endeavours’ and ‘reasonable endeavours’. He herewith sought analogical support in English law for the proposition that a good faith duty qualifies the pursuit of self-interest but does not demand that a person should no longer pay attention to its own commercial interests. McKendrick, *supra* note 42, at 693-96.

65. *BBC Worldwide Ltd. v. Bee Load Ltd. (t/a Archangel Ltd)*, [2007] EWHC 134.

66. *Id.* ¶ 95.

67. GOODE, *supra* note 32, at 3-4.

what he privately knows, to draw the other party into a bargain, from ignorance of that fact, and his believing to the contrary.”<sup>68</sup> There is nevertheless no *general principle* of good faith, nor any other general principle that protects the parties against unfairness or unreasonableness. Parties should look out for themselves and are allowed to pursue their own interests without having to concern themselves with the interests or fair position of their contracting parties. However, this does not imply that English law neglects “*the reasonable expectations of honest men*”<sup>69</sup>; indeed it maintains a standard of honesty and fairness that is analogous to the solutions offered under the civil law standard of good faith. English modern contract law, in fact, recognizes various rules that limit an unrestrained application of the principle of freedom of contract.<sup>70</sup> In other words, although good faith cannot be considered an ‘organizing principle’, English law does to a certain extent strive for contractual justice.<sup>71</sup> This is done on a more casuistic basis and by offering a variety of so-called ‘piecemeal’ (and functionally equivalent) solutions as will be explained in the following Parts.

Today, the use of the notion of good faith is restricted to specific contracts. The legislature assigned a particular role to the express duty of good faith in several legal contexts.<sup>72</sup> The following paragraphs will focus on the ‘good faith culture in consumer setting’ since that has represented a particularly sensitive point in English law.<sup>73</sup> Several European Directives were implemented in English law introducing a good faith obligation into the English legislation.<sup>74</sup> It was the implementation of the Directive on Unfair Terms in Consumer Contracts, though, that caused debate, much more so than was the case with the Agency Directive a year before. There are also contractual relations in

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68. Carter v. Boehm, [1766] 3 Burr. 1907.

69. J. Steyn, Contract Law: Fulfilling the Reasonable Expectations of Honest Men, 113 LAW Q. REV. 433 (1997).

70. COLLINS, *supra* note 31, at 181.

71. The distinction between good faith as an organizing principle and the issue of contractual justice was pointed out by C. Willett, in his contribution *Good Faith and Consumer Contract Terms*, in R. Brownsword et al. (eds.), GOOD FAITH IN CONTRACT: CONCEPT AND CONTEXT 68 (Hants, Dartmouth—Ashgate 1998) [hereinafter Brownsword et al.].

72. See, e.g., Sale of Goods Act 1979, art. 61(3) (“*A thing is deemed to be done in good faith within the meaning of this Act when it is in fact done honestly, whether it is done negligently or not.*”).

73. Brownsword et al., *supra* note 71, at 5.

74. Examples of legislation that implemented a European Directive and thereby introduced a good faith obligation are: Commercial Agents Regulations 1993 (see regulation 3); Unfair Terms in Consumer Contracts Regulations 1994 and 1999 (see regulation 4 and 5 respectively); Consumer Protection Regulations 2000 (see regulation 7); Financial Services Regulations 2004 (see regulation 7).

which parties have a duty to disclose particular information because they are operating in a context in which such ‘qualified duty of good faith’ can be expected. I will now review specific contracts in which one or more parties bear a duty of utmost good faith or have certain fiduciary duties.

### *B. Unfair Terms in Consumer Contracts Regulations*

The English legislature adopted the Unfair Terms in Consumer Contracts Regulations of 1994 (1994 Regulations) and herewith implemented the EC Council Directive on unfair terms in consumer contracts. The 1994 Regulations were revoked and replaced by the eponymous regulations of 1999 (1999 Regulations).<sup>75</sup> Both Regulations sought to enhance consumer protection<sup>76</sup> against unfair standard<sup>77</sup> terms in contracts consumers might conclude with sellers/suppliers.<sup>78 79</sup> The Regulations for instance provide that the interpretation that is most favorable to the consumer shall in principle prevail when a contract term is unclear.<sup>80</sup> Another example is the rule that a consumer may avoid a contract term that is unfair.<sup>81</sup> The Regulations provide for prevention of the use of unfair terms through injunctive relief. The Director General of Fair Trading (DGFT) as well as a “*qualifying body*”<sup>82</sup> may apply for an injunction against any person who appears to be using or recommending the use of an unfair term in a standard contract.<sup>83</sup> The DGFT did this for

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75. For a discussion on the Regulations, see S. Bright, *Winning the Battle Against Unfair Contract Terms*, 20 LEGAL STUD. 331-52 (2000).

76. The term ‘consumer’ is defined in section 3 of the 1999 Regulations as “*any natural person who, in contract, covered by these Regulations, is acting for purposes which are outside his trade, business or profession*”.

77. The Regulations are only applicable to a term which has not been individually negotiated, or in other words “*where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term*”. Section 5(1) 1999 Regulations.

78. A ‘seller or supplier’ is defined in section 3 of the 1999 Regulations as “*any natural or legal person who, in contracts covered by these Regulations, is acting for purposes relating to his trade, business or profession, whether publicly owned or privately owned*”. About the extension of the definition of seller or supplier to public authorities, see case law cited by C. Twigg-Flesner, *The Implementation of the Unfair Contract Terms Directive in the United Kingdom*, 235 CONTEMP. ISSUES IN LAW 242-43 (2006/2007), available at SSRN: <http://ssrn.com/abstract=1399631>.

79. On an interpretation by the European Court of Justice of these terms in the Directive, see W.C.H. Ervine, *The Unfair Terms in Consumer Contracts Regulations in the Courts*, 21 SCOTS L. TIMES 127-31 (2004).

80. Section 7(2) of the 1999 Regulations.

81. Section 8 of the 1999 Regulations.

82. Schedule 1 of the 1999 Regulations indicate what these qualifying bodies are.

83. Section 12 of the 1999 Regulations.

the first time in what is known as the First National Bank case.<sup>84</sup> This case is discussed in paragraph number 26.

Important for our analysis regarding good faith is the standard of fairness to which the Regulations hold the contracting parties. The definition of ‘fairness’ in the 1994 and 1999 Regulations contains a similar reference to the requirement of good faith. Section 5(1) of the 1999 Regulations stipulates: “*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.*” This was a literal transposition of article 3, 1, of the Unfair Consumer Terms Directive.<sup>85</sup> The fact that the notion of good faith is used as one of the criteria to establish unfairness of a contract term, creates a somehow exceptional situation for English law.

The 1994 Regulations list a number of factors that could be taken into account when making an assessment of the good faith requirement. While leaving room for other elements, Schedule 2 of the 1994 Regulations state:

[R]egard shall be had in particular to: (a) the strength of the bargaining positions of the parties; (b) whether the consumer had an inducement to agree to the term; (c) whether the goods or services were sold or supplied to the special order of the consumer, and (d) the extent to which the seller or supplier has dealt fairly and equitably with the consumer.

The 1999 Regulations do not repeat this list of requirements. This omission does not exclude that these requirements still be legitimately applied to test the requirement of good faith. This is all the more so, since the four grounds can also literally be found in recital 16 of the Directive.<sup>86</sup> Recital 16 explains the meaning of the inclusion of the good faith requirement in the test for assessing the unfair character of terms. It states that such assessment “*in particular in sale or supply activities of a public nature providing collective services which take account of solidarity among users, must be supplemented by a means of making an overall evaluation of the different interests involved; whereas this*

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84. *Dir. Gen. of Fair Trading v. First Nat’l Bank Plc*, [2000] 1 All ER 240.

85. The Regulations mirror the Directive also in other respects, such as the insertion of an indicative list of unfair terms in the Regulations that is identical to the list found in the annex to the Unfair Consumer Terms Directive. See Schedule 2 and respectively Schedule 3 to the 1999 and 1994 Regulations.

86. And also resemble the provisions in the Unfair Contract Terms Act 1977 that sets forth the guidelines for the application of the reasonableness test. See Provisions a, b, e of Schedule 2 of the UCTA 1977.

*constitutes the requirement of good faith*". The Directive seeks to establish an autonomous interpretation of the term good faith.

*C. DGFT v. First National Bank: The Autonomous Meaning of Good Faith in the Consumer Context*

It seems that the English courts have adopted a European interpretation of good faith when applying the test proscribed in section 5 of the 1999 Regulations (c.q. section 4 of the 1994 Regulations). There is, however, not a great deal of consistent authoritative case law reported that substantiates the assertion that the English courts acknowledge the European origin of the concept of good faith in the Regulations.<sup>87</sup> One important decision demonstrates that the law lords accepted that the good faith requirement should be understood in English law. This is the previously discussed case of Director General of *Fair Trading v. First National Bank plc.*<sup>88 89</sup> The decision turned on the question of whether a non-merger clause contained in a loan agreement between a consumer/borrower and a bank/lender was unfair for the purposes of regulation 4 of the 1994 Regulations.

The First National Bank case was filed on a summons of the DGFT for an injunction restraining the further use of the First National Bank's standard form loan agreement. Under these terms, the First National Bank agreed to loan money to a borrower for a specified period of time in consideration for the borrower's promise to repay the loan in installments and with interest. The Bank's standard form loan agreement

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87. The European Court of Justice made it clear that it would not serve as a supranational appellate court reviewing whether the national courts correctly applied the Directive. The Court stated the following:

*[T]he Court may interpret general criteria used by the Community legislature in order to define the concept of unfair terms. However, it should not rule on the application of these general criteria to a particular term, which must be considered in the light of the particular circumstances of the case in question.*

Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v. Hofstetter, C-237/02, Apr. 1, 2004, 2 CMLR 13, para. 22; see also M. Schillig, *Inequality of Bargaining Power Versus Market for Lemons: Legal Paradigm Change and the Court of Justice's Jurisprudence on Directive 93/13 on Unfair Contract Terms*, 33 EUR. L. REV. 336-58 (2008).

88. Dir. Gen. of Fair Trading v. First Nat'l Bank Plc, 25 Oct. 2001, [2002] 1 AC 481. For a discussion of this case, see: C. Twigg-Flesner, *A 'Good Faith' Requirement for English Contract Law?*, 9 NOTTINGHAM L.J. 80-84 (2000); Whittaker, *supra* note 5 at 75-98.

89. A much-anticipated test case was expected to provide us with an interesting view on good faith, though did not fulfill those expectations in the first instance, nor before the Court of Appeal and neither when a decision was more recently (November 25, 2009) rendered by the Supreme Court. See: Office of Fair Trading v. Abbey Nat'l Plc & Others, [2009] 2 C.M.L.R. 30; OFT v Abbey Nat'l plc & Others, [2008] E.W.H.C. 175 (Comm.); Office of Fair Trading v. Abbey Nat'l Plc & Others, [2009] UKSC 6.

stated that repayment of an installment should be carried out at specified dates and that time would be of the essence in this relationship. Condition 8 of the agreement further provided that if the borrower failed to pay in timely fashion after being formally reminded, the Bank

will be entitled to demand payment of the balance on the customer's account and interest then outstanding ( . . . ) Interest on the amount which becomes payable shall be charged in accordance with condition 4 ( . . . ) until payment after as well as before any judgment (such obligation to be independent of and not to merge with the judgment). [emphasis added]

This last sentence of condition 4 was the source of the DGFT's decision to ask for an injunction against this condition.

The Bank argued that this non-merger clause was a core term within regulation 3(2) of the 1994 Regulations and therefore could not be assessed as to its fairness under regulation 4. The House of Lords did not follow this argument. In fact, it went on to evaluate the fairness of condition 8 on the basis of the composite test set out in regulation 4(1). The House of Lords acknowledged that this term might indeed contain several surprising consequences for the consumer. While the court extended the time for repayment of the loan, the borrower would remain liable for the interest (at the contractual rate) that accrued during the period of time for which the court extended the repayment of the loan and this pursuant to this condition 8. In other words, the obligations arising under the contract continued to exist. Because of this clause, the borrower would lose the advantage of the rule under common law that contractual debts are indistinct from debt that arises on judgment. The House of Lords, however, held that the non-merger clause did not violate or undermine the statutory regime, nor was it an unfair term.

Lord Bingham of Cornhill's reasoning leading up to this conclusion set the tone for the interpretation of the fairness and good faith requirement in regulation 4. It is generally understood that a term is unfair if it causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer and in a manner which is contrary to the requirement of good faith. Lord Bingham understood regulation 4 as laying down a composite test covering both the making and the substance of a contract. He distinguished between the criterion of significant imbalance, which he considered a substantive element of the test, and the requirement of good faith, which marks a more objective standard. With regard to the latter, Lord Bingham held that the fairness test laid down by regulation 4 derived from article 3(1) of the Directive and recognized that "*the member states have no common concept of fairness or good faith, and the Directive does not purport to state the law*

*of any single member state*". He, decided, however that it is not necessary to seek a ruling from the European Court of Justice on the interpretation of this requirement, since the language used in the test is clear and not easily subject to differing interpretations. He suggested, moreover, that it should be given an autonomous European interpretation that is not restricted to any pre-existing domestic notion of good faith. He explained that the "*requirement of good faith in this context is one of fair and open dealing*". [emphasis added] He defined openness as the requirement that all terms should be expressed fully clearly and legibly, and contain no concealed pitfalls or traps. In essence this meant that "*appropriate prominence should be given to terms which might operate disadvantageously to the customer*". Fair dealing required the seller not to take advantage of the "*consumer's necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or any other factor listed in or analogous to those listed in Schedule 2 of the Regulations*." Lord Bingham finally stated that "*good faith in this context is not an artificial or technical concept; nor, ( . . . ) is it a concept wholly unfamiliar to British lawyers. It looks to good standards of commercial morality and practice*." [emphasis added] Lord Bingham was also careful to point out the limits of his definition to "*this context*" of the Unfair Terms in Consumer Contracts Regulations.<sup>90</sup> He also seemed to define good faith as a rule of conduct during the negotiation process rather than as a substantive requirement regarding the content of the contract terms.

Lord Millett, however, initially emphasized the content of the clause in testing the *unfairness* of a contractual term. He stated that there is no single test to assess whether a term, contrary to the requirement of good faith, causes a significant imbalance in the parties' rights and obligations. He held that it would obviously be useful to evaluate the "*impact of an impugned term on the parties' rights and obligations*"<sup>91</sup>. He went on to adumbrate a list of factors that could also be taken into consideration when assessing the fairness of the term. These are:

the effect of the inclusion of the term on the substance or core of the transaction; whether if it were drawn to his attention the consumer would be likely to be surprised by it; whether the term is a standard term, not merely in non-negotiable consumer contracts, but in commercial contracts freely negotiated between parties acting on level terms and at arms' length; and whether, in such cases, the party adversely affected by the inclusion of

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90. This is in line with the case law discussed under title 1.

91. Dir. Gen. of Fair Trading v. First Nat'l Bank Plc, 25 Oct. 2001, [2002] 1 AC 481, para.

the term or his lawyer might reasonably be expected to object to its inclusion and press for its deletion.<sup>92</sup>

From this opinion, it is less clear which meaning Lord Millett put on the *good faith* notion and what weight he attributed to this component of the fairness test. Lord Millett did not seem to conceive this as a composite test but proposed rather to conduct a multi-tiered inquiry that includes various factors. He indicated that the proposed list was not exhaustive and that other approaches might sometimes be more appropriate. He left this determination up to the court's sound judgment.

Lord Steyn and Lord Hope of Craighead also made interesting contributions to the discussion of the meaning of good faith. Lord Steyn relied on indications set forth in schedules 2 and 3 of the 1994 Regulations from which he deduced that the notion of good faith referred to an objective criterion and imported the notion of open and fair dealing. From the examples listed in Schedule 3 it was, according to this Lord, clear that "*any purely procedural or even predominantly procedural interpretation of the requirement of good faith must be rejected*".<sup>93</sup> In other words, the good faith standard was essential and the use of it could not be limited to the mere transaction of a contract, but could also weigh on the content of an agreement. Lord Steyn for instance referred to the Principles of European Contract Law and the meaning therein of the notion of good faith and fair dealing, which was "*to enforce community standards of decency, fairness and reasonableness in commercial transactions*". Lord Hope of Craighead also referred to the PECL, as well as to recital 16 to the Directive in which it was explained what constituted the requirement of good faith.

Thus there was an important discussion as to whether the good faith requirement provided for in the Unfair Terms in Consumer Contracts Regulations ought to be understood as simply a procedural requirement. Chen-Wishart, for instance stated that, although Lord Bingham explicitly linked 'good faith' to procedural unfairness, "*his Lordship's description of it incorporates clear non-procedural elements*".<sup>94</sup> She then cited the excerpt in which Lord Bingham noted that "*appropriate prominence should be given to terms which might operate disadvantageously to the*

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92. *Id.*

93. The indicative list of terms enumerated in Schedule 3 of the Unfair Terms in Consumer Contracts Regulations 1994 indeed primarily refers to the content of a contract. It, however, clearly defines these examples as "*terms which may be regarded as unfair*" [emphasis added]. It is not only referring to good faith, but rather to the overall requirement of fairness as described in regulation 4.

94. M. Chen Wishart, *Unfairness of Bank Charges*, 124 LAW Q. REV. 565 (2008).



*customer*". I am not convinced by this argument. First of all, Lord Bingham required such "*appropriate prominence*" in the context of his exposé on openness and of the obligation to alert a party of disadvantageous terms. His statement thus seemed to underline a duty of information, rather than to pursue explicating a substantive requirement. Secondly, Lord Bingham started from the premise that "*Regulation 4(1) lays down a composite test, covering both the making and the substance of the contract*"<sup>95</sup>. There is on the one hand the good faith requirement, and the component relating to the 'significant imbalance'. The emphasis he placed on the procedural aspect of contracting primarily related to this first component.

The distinction made between the different components of the unfairness test is admittedly somewhat artificial. The Regulations do not indicate any requirement for such a distinction. The examples given in the appendices to the Regulations (the so-called "Schedules") relate to terms that are 'unfair' both from a substantive as from a procedural point of view. Lord Steyn shared this observation to underscore his point that "*the argument (. . . ) that good faith is predominantly concerned with procedural defects in negotiating procedures cannot be sustained*"<sup>96</sup>.

It is apparent from a case-law review on the unfairness test that the courts only rarely make distinctions that separately examine whether the good faith requirement was met. In some of those cases, though, the courts clearly followed Lord Bingham's reasoning and explicitly evaluated whether the *conclusion* of a contract met the standard of good faith set out in the First National Bank case.<sup>97</sup> The courts' specific attention to the procedural unfairness of a contract makes sense given the *ex post facto* nature of their interventions. The assessment of unfair terms by the Director General of Fair Trading and other qualifying bodies on the contrary, focuses more on the substantive aspect of unfairness. This is logical given the pre-emptive character of such investigation and the injunction potentially arising out of it; certain terms are considered unfair on the basis of their content, and abstracting the circumstances in which the particular term is used. Hence: the mainly substantive

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95. Dir. Gen. of Fair Trading v. First Nat'l Bank Plc, 25 Oct. 2001, [2002] 1 A.C. 481, para. 17.

96. *Id.* para. 36.

97. Examples are two decisions of the High Court of Justice Queen's Bench Division Technology and Construction Court: *Westminster Building Co. v. Andrew Beckingham*, 20 Feb. 2004, on the Westlaw database under reference 2004 WK 343614; *Bryen & Langley Ltd. v. Martin Rodney Boston*, on the Westlaw database under reference 2004 WL 252654.

guidance given by the DGFT on its website on “*terms that may be considered unfair*”<sup>98</sup>.

Another important observation regarding this case is that the Lords—and Lord Bingham and Lord Hope of Craighead do this explicitly—agree that for defining the meaning of good faith, attention must be paid to the Directive rather than to the interpretation given to this concept in the European national legal systems. Lord Hope of Craighead stated that the meaning of ‘unfair’ in regulation 4(1) of the 1994 Regulations guidance is to be found in the sixteenth recital of the Directive, which explains what constitutes the requirement of good faith.<sup>99</sup> Lord Bingham also takes note of the autonomous interpretation of the European good faith-notion. The test laid down in the Directive “*does not purport to state the law of any single member state*”<sup>100</sup>. He refers to the European Court of Justice as the proper authority to interpret the concept of fairness or good faith in case its meaning would be “*doubtful, or vulnerable to the possibility of differing interpretations in differing member states*”<sup>101</sup>. It is remarkable that the House of Lords recognized that this good faith rule is an autonomous European creation which derives its legitimacy from the European purpose and meaning of article 3 of the Directive 93/13.

#### *D. Utmost Good Faith and Fiduciary Relationships*

Good faith has been part of the English legal lexicon in certain contractual relationships where a qualified duty of good faith plays a regulatory role.

There is for instance a class of contractual relationships in which parties are supposed to observe a standard of ‘*utmost good faith*’ or ‘*uberrimae fidei*’. Although this legal doctrine is articulated by reference to ‘good faith’, it primarily conveys a stricter *duty of disclosure*. Mere non-disclosure of a fact, in principle, does not automatically lead to an unenforceable contract for reason of misrepresentation. An elevated duty of disclosure is, however, exacted from the parties involved in contracts in which one party is in a manifest better position than the other party to know about material facts that are relevant to the contract.<sup>102</sup> This legal

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98. See Annexe A to the leaflet providing general guidance (published September 2008) on the Unfair Terms in Consumer Contracts Regulations 1999 of the Office of Fair Trading that can be found on the Web site of the OFT, <http://www.offt.gov.uk>.

99. Dir. Gen. of Fair Trading v. First Nat'l Bank Plc, 25 Oct. 2001, [2002] 1 A.C. 481, para. 45.

100. *Id.* para. 17.

101. *Id.*

102. PEEL, *supra* note 29, at 430.

doctrine is at odds with the generally accepted maxim of *caveat emptor* that pervades English contract law. Its application remains restricted to certain kinds of contracts. An insurance contract provides a perfect example of a contract *uberrimae fidei*.<sup>103</sup> The duty of utmost good faith here is based on section 17 of the Marine Insurance Act 1906<sup>104</sup> that is presumed to apply equally to other types of insurance.<sup>105</sup> This doctrine at the pre-contractual stage<sup>106</sup> entails that each party is obliged to disclose material facts even if no question is asked and *a fortiori* has to refrain from misrepresenting these facts<sup>107</sup>. This is a mutual and reciprocal duty. This is clear from the wording in section 17 of the Marine Insurance Act 1906 which states that “*if the utmost good faith be not observed by either party, the contract may be avoided by the other party*”. This duty of utmost good faith, however, bears more heavily on the insured party than on the insurer. Section 18 explicitly sets out the duty of disclosure of the insured. The insured must reveal all material facts<sup>108</sup> which a prudent insurer would consider when deciding under what conditions he would willingly conclude an insurance contract. The ‘utmost good faith’ in this context insists on honesty and fairness.<sup>109</sup> An insurer may avoid the

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103. *Id.* at 432. There are also other contracts in which this standard is applicable such as contracts to subscribe for shares in a company, family settlements and partnerships. The Law Commission Consultation Paper Number 182 and the Scottish Law Commission Discussion Paper Number 134, Insurance contract law: Misrepresentation, non-disclosure and breach of warranty by the insured—A joint consultation paper, 2006, 23, n.4.

104. Section 17 states: “*A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.*”

105. The Law Commission Consultation Paper Number 182 and the Scottish Law Commission Discussion Paper Number 134, Insurance contract law: Misrepresentation, non-disclosure and breach of warranty by the insured—A joint consultation paper, 2006, 22.

106. The duty of utmost good faith at the post-contractual stage is more controversial though such duty has been accepted in a number of cases. *See*: A. Naidoo & D. Oughton, *The Confused Post-Formation Duty of Good Faith in Insurance Law: From Refinement to Fragmentation to Elimination*, 2005 J. BUS. L. 346-71; C. Butcher, *Good Faith in Insurance Law: A Redundant Concept*, 5 J. BUS. L. 380-84 (2008); N.J. Hird, *Utmost Good Faith—Forward to the Past*, 2005 J. BUS. L. 260-61; N.J. Hird, *The Star Sea—The Continuing Saga of Utmost Good Faith*, 2001 J. BUS. L. 311-17. This latter author mentioned the “*expansionist trend in the courts*” with regard to the duty of utmost good faith by referring to case law such as *Black King Shipping Corp. v. Massie* [1985] 1 Lloyd’s Rep. 437, and *Bank of Nova Scotia v. Hellenic Mutual War Risks Ass’n (Bermuda) Ltd.* [1990], 1 Q.B. 818, CA.

107. The Law Commission Consultation Paper Number 182 and the Scottish Law Commission Discussion Paper Number 134, Insurance contract law: Misrepresentation, non-disclosure and breach of warranty by the insured—A joint consultation paper, 2006, 23.

108. For case law on what constitutes ‘material circumstances’, see: H.N. Bennett, *Utmost Good Faith in the House of Lords*, 111 LAW Q. REV. 181-86 (1995); PEEL, *supra* note 29, at 430-31.

109. O’CONNOR, *supra* note 5, at 45; *see also* D. Friedmann, *The Transformation of ‘Good Faith’ in Insurance Law*, in Brownsword et al., *supra* note 71, at 311-26; J.H. BOTES, FROM GOOD

contract if the duty of disclosure is not fulfilled. The consumers' duty to disclose is controversial under English law.<sup>110</sup>

A qualified duty of good faith has also been explicitly imposed upon parties who assume fiduciary duties. The term 'fiduciary' is borrowed from Latin and expresses an idea of trust, confidence, faith and honesty. 'Fides' is the Latin word that conveys these meanings. It thus has the same etymological origin as 'good faith'. Fiduciary duty and good faith both connote standards of integrity. A fiduciary duty exists when a relationship is built on trust. That is the case when one person relies on his contracting party to act as a 'fiduciary', or in other words when this person "*has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence*".<sup>111</sup> The Law Commission's report on 'Fiduciary duties and regulatory rules' broadly classified the fiduciary's obligations into four categories or rules.<sup>112</sup> First of all, there is the 'no conflict'-rule according to which a fiduciary must not place himself in a position where his own interests conflict with those of the beneficiary who is his customer. Secondly, the 'no profit'-rule implies that the fiduciary must not profit from his position at the expense of the beneficiary. Thirdly, the 'undivided loyalty' rule prescribes that a fiduciary owes undivided loyalty to the beneficiary and promises not to place himself in a position that would cause a conflict between the duties he owes to his respective customers. This rule implies that the fiduciary should make available to a customer all information that is relevant to the customer's affairs. Finally, there is a duty of confidentiality as a result of which a fiduciary may only use information obtained in confidence from the customer for the customer's benefit and not to the fiduciary's own advantage or that of a third person. The Law Commission Report does not qualify the fiduciary duty by reference to good faith. Courts on the contrary have on several occasions explicitly linked the duty of good faith to a fiduciary's

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FAITH TO UTMOST GOOD FAITH IN MARINE INSURANCE 239 (Frankfurt am Main, Peter Lang GmbH 2005).

110. Serious consideration is given to the reform of these rules of law. See: Law Commission Consultation Paper Number 182 and the Scottish Law Commission Discussion Paper Number 134, Insurance contract law: Misrepresentation, non-disclosure and breach of warranty by the insured—A joint consultation paper, 2006, 31, published on the Web site of the Law Commission, at <http://www.lawcom.gov.uk/docs/cp182.pdf>. This Consultation paper (as well as and the existing law) has been commented on and criticized by B. Soyer, *Reforming Pre-Contractual Information Duties in Business Insurance Contracts—One Reform Too Many?*, 1 J. BUS. L. 15-43 (2009); Butcher, *supra* note 106, at 375-84.

111. *Bristol & W. Bldg. Soc'y v. Mothew*, [1998] Ch. 1, at 18A.

112. Law Comm'n, *Fiduciary Duties and Regulatory Rules 2* (Law Commission Consultation Paper Number 236, 1995).

obligations.<sup>113</sup> Lord Justice Millett, for instance, expressly stated with regard to the duty of a solicitor that “*A fiduciary must act in good faith*”.<sup>114</sup> In *Simpson v. Harwood Hutton* Judge Richard Seymour held that an agent’s fiduciary duty towards the counterparty is a “*duty of good faith*”.<sup>115</sup> This has also been expressly stated with regard to the fiduciary’s duties towards trustees<sup>116</sup>, company directors<sup>117</sup>, employees<sup>118</sup>, partners in a partnership contract<sup>119</sup>, and accountants<sup>120</sup>.

### *E. Express Duty of Good Faith*

In certain forms of contract, parties also expressly agree upon an obligation made in good faith. This ‘soft obligation’ is frequently inserted in partnering contracts in which concepts of fair and reasonable

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113. For an extensive description of a fiduciary duty including a duty of good faith, see for instance, *JD Wetherspoon Plc v. Van de Berg & Co.*, [2009] EWHC 639 (Ch), para. 39.

114. Lord Justice Millett, for instance, expressly stated that “*A fiduciary must act in good faith*”. *Bristol & W. Bldg. Soc’y v. Mothewe*, [1998] Ch. 1, at 18B.

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*Even if a fiduciary is properly acting for two principals with potentially conflicting interests he must act in good faith in the interests of each and must act with the intention of furthering the interests of one principal to the prejudice of those of the other . . . I shall call this ‘the duty of good faith’.*

*Simpson v. Harwood Hutton (A Firm)*, [2008] EWHC 1376, para. 108. On the fiduciary duties of an agent, see also I. Brown, *Divided Loyalties in the Law of Agency*, 109 LAW Q. REV. 206-10 (1993), where he discussed the fiduciary duties of an estate agent as was set out in the case of *Kelly v. Cooper*, [1993] A.C. 205 (PC Ber). See also: *Connolly v. Brown*, 2007 SLT 778; *A v. B & Others*, [2007] 2 CLC 157; *Také v. BSM Mktg.*, 2006 WL 2133130.

116. *A v. A, St George Trs. Ltd. & Others*, [2007] EWHC 99, para. 86; *Abou-Rahmah & Others v. Abacha & Others*, [2005] EWHC 2662, at 485.

117. *Progress Prop. Co. v. Moore*, [2008] EWHC 2577, para. 45; *Kynixa Ltd v. Hynes*, [2008] EWHC 1495, para. 189; *Thunder Air Ltd v. Hilmarsson*, [2008] EWHC 355, para. 13; *PNC Telecom Plc v. Thomas*, [2007] EWHC 2157, para. 31; *In re Eurocruit Europe Ltd.* (in liquidation) *Goldfarb v. Poppleton*, [2007] EWHC 1433, at 146; *Foster Bryant Surveying Ltd. & Another v. Bryant & Others*, [2007] Bus. L.R. 1565, para. 8; *Shepherds Invs. Ltd. v. Walters*, [2007] FSR 15, at 398; *Ultraframe (UK) Ltd v. Gary Fielding & Others*, [2005] EWHC 1638, para. 1436; *Fulham Football Club (1987) Ltd. v. Tigana*, 2005 WL 5249806, paras. 11, 35. For a specification on how the director’s fiduciary duties should be interpreted, see, for example: R.C. Nolan, *Controlling Fiduciary Power*, 68 CAMBRIDGE L.J. 293-323 (2009); A. Alcock, *An Accidental Change to Directors’ Duties?*, 30 COMPANY LAW. 362-68 (2009); R. Lee, *Rethinking the Content of the Fiduciary Obligation*, 3 CONVEYANCER & PROP. LAW. 236-53 (2009).

118. *Crowson Fabrics Ltd. v. Rider*, [2008] FSR 17, at 426; *Hanco ATM Sys. Ltd. v. Cashbox ATM Sys. Ltd.*, [2007] EWHC 1599, para. 42; *Pennwell Publ’g (UK) Ltd. v. Ornstien*, [2007] EWHC 1570, para. 66; *Beckett Inv. Mgmt. Group Ltd. v. Hall*, [2007] EWHC 241, para. 9. A subtle differentiation and nuance can be found with: *Helmet Integrated Sys. Ltd. v. Tunnard*, [2007] FSR 16, at 448.

119. *Reeves v. Sprechter*, [2008] EWHC 583; *Forster v. Ferguson & Forster*, 2008 SLT 52; *Ross River Ltd., Blue River LP v. Cambridge City Football Club*, 2007 WL 2817805.

120. *Simpson v. Harwood Hutton (A Firm)*, [2008] EWHC 1376, para. 108.

dealing and good faith are essential.<sup>121</sup> To sketch the evolution of the use of an express term on good faith in contracts would require more extensive primary research than can be covered in this Paper.<sup>122</sup>

### III. GOOD FAITH AS AN IMPLICIT CONCEPTUAL BASIS

Next to these explicit applications of the notion of good faith, there are some rules in English law, which reflect the moral imperatives of the good faith principle. These rules are not defined in terms of good faith or even fairness. They do, however, serve a similar function. A methodology through which these rules can be assessed is the ‘functionalist comparative method’.<sup>123</sup>

This functionalist approach involves determining the ‘function’ of the institution of good faith as an operative in a given legal system. A selected frame of reference, for instance, could be my own Belgian legal system. I prefer to follow a different course and will rely on the findings of two leading scholars who set the notion of good faith in the larger context of *European* contract law. Zimmermann and Whittaker reported their findings in a seminal study exploring the concept of good faith. Their work *Good Faith in European Contract Law* (2000) provides a starting point for exploring the various iterations of good faith raised in this Paper. A reason for choosing a European approach is that examining good faith from the perspective of various legal systems invariably allows a broader conception of the possible roles the good faith requirement might fulfill. The good faith requirement under Belgian law presumably is applied more narrowly.<sup>124</sup>

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121. S. Jackson, Good Faith in Construction—Will It Make a Difference and Is It Worth the Trouble, 23 CONSTRUCTION L.J. 420-35 (2007).

122. On the attempt to gather numerical information on the practice to insert good faith clauses into a contract, see the description of my qualitative research under title 4.

123. About the functionalist methodology, see K. ZWIEGERT & H. KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW 34 *et seq.* (Oxford, Clarendon Press 1998). *See also*: A.E. Öricü, *Methodology of Comparative Law*, in J.M. Smits (ed.), ELGAR ENCYCLOPEDIA OF COMPARATIVE LAW 443 *et seq.* (Cornwall, Edward Elgar Publ’g 2006); R. Michaels, *The Functional Method of Comparative Law*, in M. REIMANN & R. ZIMMERMANN, THE OXFORD HANDBOOK OF COMPARATIVE LAW 339 *et seq.* (Oxford, Oxford Univ. Press 2006).

124. Article 1134, 3, of the Belgian Civil Code for instance deals with the performance of a contract and does not explicitly refer to the pre-contractual duty of good faith. It states that agreements must be forged in good faith. This had led the majority of courts and scholars to argue that this provision is the basis on which the courts may step in to rectify a situation in which the contracting parties have acted contrary to good faith in the performance of their contracts. Yet, it usually does not serve as a basis for finding liability during the pre-contractual stage. On good faith in Belgian law, see: J. Baeck, *Gevolgen tussen partijen [verbintenissen]*, in X., BIJZONDERE OVEREENKOMSTEN. ARTIKELSGEWIJZE COMMENTAAR MET OVERZICHT VAN RECHTSPRAAK EN RECHTSLEER, IV. Commentaar verbintenissenrecht, Titel II, Hfdst. 6, 111 pages; E. Dirix, *Over de beperkende werking van de goede trouw*, TIJDSCHRIFT VOOR BELGISCH

In 2000 Zimmermann and Whittaker released the results of this extensive study regarding the meaning and role of good faith in European contract law.<sup>125</sup> This study demonstrates the various situations in which the principle of good faith might be invoked. Zimmermann and Whittaker distinguished four groups of doctrines of modern contract law that express the idea of good faith. A first cluster of doctrines aims to resolve pre-contractual problems. The authors found that “*there is a clear relationship in the modern law between an analysis in terms of the requirements of good faith and one in terms of defects in consent of one party and/or the sanctioning of wrongdoing in the other*”.<sup>126</sup> A second group describes situations in which the wrongful nature of a party’s conduct or his abuse of rights is considered contrary to ‘public policy’ rather than a direct infringement of the good faith requirement.<sup>127</sup> Thirdly, the authors indicated that there is an “*intimate relationship ( . . . ) between issues of interpretation ( . . . ) and good faith*” and herewith established the regulatory function of good faith. This can permit the courts to take parties’ expectations as well as broader normative considerations into account when deciding upon the significance of a contract term.<sup>128</sup> Finally, they also discerned a parallel between the “*substantive injustice of the contract more generally*” and the recourse courts take to ideas of good faith or bad faith.<sup>129</sup>

These authors went on to discuss five specific rules that are based on good faith or that concern a negation of bad faith. They clearly suggested, however, that this is hardly an exhaustive list of possible meanings that might be ascribed to the notion of good faith. They firstly referred to situations where a lack of honesty constitutes bad faith. One consequence of this particular conception is the duty of disclosure that arises in certain legal systems.<sup>130</sup> A second requirement of good faith is that contracting parties are bound to keep their word.<sup>131</sup> Thirdly, it is largely considered ‘bad faith’ for the parties to act in an unreasonable manner or without any legitimate interest in order to push the other party

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HANDELSRECHT 1988, 660-66; A. De Boeck, *Precontractuele aansprakelijkheid, in X., BIJZONDERE OVEREENKOMSTEN. ARTIKELSGEWIJZE COMMENTAAR MET OVERZICHT VAN RECHTSPRAAK EN RECHTSLEER, IV. Commentaar Verbintenissenrecht, Titel II, Hfdst. 3, Afd. 6, 29 pages*

125. Zimmermann & Whittaker, *supra* note 6 at 720.

126. *Id.* at 678.

127. *Id.* at 678-79.

128. *Id.* at 679.

129. *Id.* at 682.

130. *Id.* at 691.

131. *Id.*

into a weaker position. This reflects the duty of contractual loyalty.<sup>132</sup> Fourthly, the element of fairness that is part of most conceptions of good faith imports the rule that “*parties cannot be allowed to rely on, nor be kept to, an absurdity which appears to follow from their agreement*”.<sup>133</sup> Finally, their study shows that most legal systems consider a deliberate breach of a contract as constituting bad faith.<sup>134</sup>

The results of this impressive study highlight the *corrective* value of a principle of good faith. Courts resort to good faith to correct a contracting party’s abusive, unreasonable or bad faith behavior, and to protect a party against unfair situations. The following paragraphs explore a number of situations in which *English* courts intervene in order to remedy unfairness that arises out of objectionable behavior without explicitly relying on the principle of good faith. These English legal doctrines and remedies can be linked to good faith and the functions it fulfills in European contract law as defined by Zimmermann and Whittaker. Without claiming to be exhaustive, I have selected<sup>135</sup> examples of rules of law that aim to solve pre-contractual problems, that correct situations considered contrary to public policy, that allow the courts to rectify situations by interpreting the parties’ intentions in hindsight when those intentions might lead to substantive injustice.<sup>136</sup>

#### A. *Precontractual Problems: Honesty and Fair Dealing*

When the parties’ free will to contract is impaired, their formal consent can be set aside in some cases. There are some mechanisms which aim to defuse the consequences of a party’s bad faith actions.

Under Common Law a contract can be voidable on the grounds of *duress*. Duress may be defined as a form of illegitimate pressure that “*brought about a coercion of the will, which vitiates consent*”<sup>137</sup>. Common Law distinguishes three types of duress. There is duress to a

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132. *Id.* at 692.

133. *Id.* at 693.

134. *Id.*

135. Zimmermann and Whittaker’s also mention a number of other doctrines that will not be dealt with in this paper, such as:

[T]he doctrine of estoppels; part performance of a contract in equity; the de minimis rule; qualifications of legal rights by reference to the notion of reasonableness; relief against forfeiture in equity; the maxim according to which ‘no man can take advantage of his own wrong’; the notion of breach of confidence; ( . . . ) the law relating to repudiation ( . . . ).

*Id.* at 676.

136. Thus, relying on the four functions set forth by these learned authors.

137. *Pao On v. Lau Yiu Long*, [1980] A.C. 614, 635-36.



person, duress to goods and economic duress.<sup>138</sup> The doctrine of duress offers a way out for a party that formally consented to a transaction but whose acceptance was the product of a choice between evils. Threat or coercion impairs the decision-making process and thus undermines the contract's legitimacy. Consent must be given in an honest and acceptable manner in such a way that freedom of contract is guaranteed.

The equitable doctrine of *undue influence* is based on a similar rationale and was meant to supplement the more narrow Common Law doctrine of duress.<sup>139</sup> Undue influence occurs when a party was induced to enter into a contract under the influence of more subtle forms of pressures. There are traditionally two different categories of situations which can render a contract void. A first main group is one in which a party accepts an offer after *actual* improper influence has been exerted by the counterparty. A second distinct category is that of presumed undue influence. In that group of cases, there is no evidence identifying actual undue influence. One must, however, prove certain specific elements that establish a presumption of undue influence.<sup>140</sup>

Another legal concept is *misrepresentation*. Under English law, parties are generally not expected to voluntarily disclose information that might have a bearing on the contract. Mere acquiescence about relevant facts does not create a cause of action. This is a result of the English legal tenet of 'caveat emptor' previously discussed in this Paper. There is yet a limit to the legitimacy of a failure to disclose relevant information. For a number of specific contractual relations parties may not take advantage of the ignorance of the counterparty: they have an active responsibility to communicate certain information.<sup>141</sup> Moreover parties should refrain from dishonesty and making false statements of law or fact, and thus not engage in what is known as 'misrepresentation'. McKendrick defines a misrepresentation as "*an ambiguous, false statement of fact or law which is addressed to the party misled, which is material (although this requirement is now debatable) and which induces the contract*".<sup>142</sup> Misrepresentation assumes myriad forms. It may, first of all, occur as a result of the representor's intentional fraudulent behavior.<sup>143</sup> Misrepresentation, however, does not necessarily imply fraud

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138. PEEL, *supra* note 29, at 442.

139. A. Hadjiani, *Duress and Undue Influence in English and German Contract Law: A Comparative Study on Vitiating Factors in Common and Civil Law*, OXFORD UNIV. COMP. L.F. 1, ouclf.iuscomp.org (text after note 161).

140. PEEL, *supra* note 29, at 374.

141. See in this regard: paragraph number 34 on fiduciary duties.

142. MCKENDRICK, *supra* note 29, at 273.

143. *Id.* at 279.

or bad faith. There is also ‘negligent’ misrepresentation. This is when the representor fails to live up to the standard of care that is prescribed by law.<sup>144</sup> The third category is ‘innocent’ misrepresentation which comprises all actionable cases of misrepresentation which are not the product of fraudulent or negligent behavior.<sup>145</sup> There are several remedies that aim to rectify the unfairness that results from misrepresentation. The deceived party, for example, may elect to rescind the contract. In the event of negligent and fraudulent misrepresentation, parties in principle have an actionable cause for damages as well.<sup>146</sup>

*B. Implied Terms: Interpretation, Public Policy, Fairness*

Implied terms are contract provisions which are not explicitly addressed by the parties in the agreement, but that courts implicitly read into the contract. By means of these implied terms, the courts supplement the parties’ provisions, oftentimes with the purpose of advancing fairness and reasonableness in the contractual relationship or to enhance business efficacy.

McKendrick distinguishes three sources of law by virtue of which the courts may ‘find’ implied terms.<sup>147</sup>

A first source of implied terms is statute law. Examples of statutory implied terms are plentiful. Think for instance of article 12 of the Sale of Goods Act 1979 providing that “*In a contract of sale ( . . . ) there is an implied term on the part of the seller that in the case of a sale he has a right to sell the goods, and in the case of an agreement to sell he will have such a right at the time when the property is to pass*”.<sup>148</sup>

Secondly, there are customary implied terms. In commercial transactions, parties are presumed to have the intention to be bound by trade customs and usages that apply to the particular sector and place in which they do business. A custom may only provide for an implied term when it is established that it is so “*generally known that an outsider who makes reasonable enquiries could not fail to be made aware of it*”.<sup>149</sup>

Thirdly, courts may imply terms based upon Common Law. There are two categories here, namely the so-called terms ‘implied in law’, and

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144. *Id.* at 279-85.

145. *Id.* at 285.

146. Though they may not choose to both recover damages and rescind the contract, if this amounts to granting the deceived party a double recovery for the same loss.

147. MCKENDRICK, *supra* note 29, at 205-08.

148. For other examples, see for instance: Article 12-15 Sale of Goods Act 1979; Articles 13-15 Supply of Goods and Services Act 1982.

149. *Kum v. Wah Tat Bank Ltd.*, [1971] 1 Lloyd’s Rep. 439, 444.

terms ‘implied in fact’.<sup>150</sup> The terms implied in law are confined to specific contractual relations in which they operate as ‘default rules’.<sup>151</sup> This use, for example, can be made in employment contracts.<sup>152</sup> Terms implied in fact allow the courts to give effect to the actual<sup>153</sup> though unexpressed intention that is attributed to the parties. They are ‘ad hoc’ or individualized gap fillers.<sup>154</sup> The courts are rather reluctant to add these kind of implied terms to the parties’ contract. The addition is confined to situations where some high standard of necessity is met. This is only justified when the implied term is so obvious that it goes without saying that it should be incorporated in the contract. The two tests that were frequently referred to in this regard are the ‘officious bystander’-test and the business efficacy-test.<sup>155</sup> The name of the former test is taken from the case of *Shirlaw v. Southern Foundries*, where Lord Justice MacKinnon explains the meaning of an implied term by referring to the situation where if “*an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common ‘Oh, of course!’*”<sup>156</sup> The second test is referred to as the ‘business efficacy’-test. This test was embodied in *The Moorcock* decision of 1889, where Lord Justice Bowen stated with regard to implied warranties or covenants in law that

*it will be found that in all of them [cases of implied warranties or covenants in law] the law is raising an implication from the presumed intention of the parties with the object of giving to the transaction such efficacy as both parties must have intended that at all events should have. ( . . . ) what the law desires to effect by the implication is to give such business efficacy to*

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150. This distinction has been recognized by Lord Bridge as a ‘clear distinction’ in the case of *Sally v. Southern Health & Social Services Board* that was referred to by Phang. See A.B.L. Phang, *Implied Terms in English Law—Some Recent Developments*, 1993 J. BUS. L. 244.

151. On the role of implied terms as ‘default rules’, see T.D. Rakoff, *Implied Terms: Of ‘Default Rules’ and ‘Situation Sense’*, in J. BEATSON & D. FRIEDMANN, *GOOD FAITH AND FAULT IN CONTRACT LAW* 191-228 (Oxford, Clarendon Press 1995).

152. X, *Implied Terms in United Kingdom Employment Law: Recent Authorities*, 1992 J. BUS. L. 433-42; H. Collins, *Legal Responses to the Standard Form Contract of Employment*, 36 *INDUSTRIAL L.J.* 2-14 (2007).

153. The courts look for the parties’ actual intention when they imply a term in fact. An implication in law is, on the contrary, based on the ‘imputed intention’ of the parties and the term it implies is rather a legal incident of a particular class of contract. C. Nicoll, *Does Termination of a Franchise of Indefinite Duration Require ‘Judicial Legislation’*, 1995 J. BUS. L. 472.

154. E. MacDonald, *Bugs and Breaches*, 13 *INT’L J. L. & INFO. TECH.* 130 (2005).

155. On the use and interpretation of both tests, see: A. Phang, *Implied Terms, Business Efficacy and the Officious Bystander—A Modern History*, 1998 J. BUS. L. 1-34; PEEL, *supra* note 29, at 223-25.

156. *Shirlaw v. S. Foundries Ltd.*, [1939] 2 KB 206, 207.

*the transaction as must have been intended at all events by both parties who are business men.*<sup>157</sup>

The majority of the Judicial Committee of the Privy Council undertook both these tests by the following summary of conditions necessary to ground an implied term:

For a term to be implied, the following conditions (which may overlap) must be satisfied: 1. it must be reasonable and equitable; 2. it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; 3. it must be so obvious that 'it goes without saying'; 4. it must be capable of clear expression; 5. it must not contradict any express term of the contract.<sup>158</sup>

The contractor's duty to warn the employer of the defects in an architect's design is an example of such a term that the court read in a standard JCT form building contract 1963 edition. The court decided that such a term was necessary to ensure a reasonable degree of business efficacy in the contract.<sup>159</sup> The Privy Council recently reviewed this rather complex formulation and provided a more simplified restatement of this test in the Belize case.<sup>160</sup> In this decision the Privy Council seems to step away from the traditional emphasis on necessity and sets in a trend that rather focuses on reasonableness ("*what the contract would reasonably be understood to mean*"<sup>161</sup>).<sup>162</sup>

This attempt to classify the separate and specific applications of 'implied terms' somewhat hushes up the real value of implied terms as a general tool that grants the court the power to rectify inherently unreasonable or unfair situations where a contract fails to deal expressly with these matters. Its overall use and function in the English courts is in other words strikingly similar to the role good faith plays on the continent. As has been indicated by Grobecker in his 'habilitation' thesis<sup>163</sup>, implied terms are summoned to support the good faith expectations of the parties involved and they fulfill a role that is similar

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157. *The Moorcock*, (1889) 14 P.D. 64.

158. *BP Refinery (Westernport) Pty Ltd. v Shire of Hastings*, (1977) 52 A.L.J.R. 20, 26.

159. For an analysis of this case and of other examples of terms implied in fact, see L.A. Rutherford & S. Wilson, *Design Defects in Building Contracts: A Contractor's Duty To Warn*, 10 CONSTRUCTION L.J. 90-99 (1994).

160. *Attorney Gen. of Belize v Belize Telecom Ltd.*, (2009) 1 W.L.R. 1988.

161. *Id.* at 1994.

162. For more information on this case and the rules ensuing from it, see, for example: C. Peters, *The Implication of Terms in Fact*, 68 CAMBRIDGE L.J. 513-15 (2009); K.F.K. Low & K.C.F. Loi, *The Many 'Tests' for Terms Implied in Fact: Welcome Clarity*, 125 LAW Q. REV. 561-67 (2009).

163. W. GROBECKER, *IMPLIED TERMS UND TREU UND GLAUBEN* (Berlin, Duncker & Humblot 1999).

to the function of the good faith principle in continental systems. Nevertheless parties may expressly exclude the implication of terms in their contract, provided that such exclusion is not prohibited by law.<sup>164</sup>

### C. *Mistake and Unfairness*

The courts may release the parties from their obligation to perform under a given contract, when the latter is based upon a *fundamental* and *common* misapprehension at the time of its conclusion. The result of common mistake is that the contract that came into being on the basis of that mistake is considered void and thus will not be enforced. The courts may also find that there was no offer and acceptance from the outset and that this was due to a unilateral mistake. In such cases, parties are considered never to have achieved a genuine agreement. Unilateral mistakes may arise as to the identity of the other contracting party, the terms and conditions of the offer and acceptance, and the subject matter of the contract. There has been debate as to the exact circumstances under which unilateral mistake may negate the parties' consent. It is generally agreed that mistakes regarding the subject matter and the identity of the contracting party negate consent provided that they were fundamental. Moreover, a mistake in all cases must induce the mistaken party to enter into an operative contract. The conditions under which the courts have found a mistake to be 'fundamental', 'operative' or 'inducing' the contract depended primarily upon the circumstances of the case and upon a profound examination of the parties' intentions. I will not go into the casuistry but rather refer to the works of several learned scholars who have addressed these issues.<sup>165</sup>

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164. Article 6 of the Unfair Contract Terms Act 1977 for instance provides:

Liability for breach of the obligations arising from (a) section 12 of the Sale of Goods Act 1979 (seller's implied undertakings as to title, etc); (b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (the corresponding thing in relation to hire-purchase), cannot be excluded or restricted by reference to any contract term.

165. PEEL, *supra* note 29, at 311-31; MCKENDRICK, *supra* note 29, at 295-308; D. McLaughlan, *The 'Drastic' Remedy of Rectification for Unilateral Mistake*, 124 LAW Q. REV. 608-40 (2008); M. Pawlowski, *Mistake, Frustration and Implied Conditions in Leases*, 11 LANDLORD & TENANT REV. 158-61 (2007); M. Smith, *Rectification of Contracts for Common Mistake*, *Joscelyne v Nissen*, and *Subjective States of Mind*, 123 LAW Q. REV. 116-32 (2007); A. Chandler, J. Devenney & J. Poole, *Common Mistake: Theoretical Justification and Remedial Inflexibility*, 2004 J. BUS. L. 34-58; C. Hare, *Inequitable Mistake*, 62 CONSTRUCTION L.J. 29-32 (2003); X, *Which Mistakes Can Be Rectified*, 23 PROP. L. BULL. 49-55 (2003); A. Phang, *Controversy in Common Mistake*, CONVEYANCER & PROP. LAW., May/June 2003, at 247-56; A. Phang, *Mistake in Contract Law—Two Recent Cases*, 61 CONSTRUCTION L.J. 272-76 (2002); M. Williams, *Contract Law: Equitable Jurisdiction in the Law of Mistake—A 50 year old Chimera or a Valid Passport to a Just Result*, 7 COVENTRY L.J. 72-78 (2002).

#### D. *The Rare Case of Frustration*

Frustration can be successfully invoked to rectify certain situations in which unforeseen contingencies have occurred. Parties may invoke frustration and thereby terminate a contract within the narrow constraints<sup>166</sup> of a particular situation.<sup>167</sup> First of all, they may do so whenever “*a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different<sup>168</sup> from that which was undertaken by the contract.*”<sup>169</sup> [emphasis added] One of the rationales behind the application of the doctrine of frustration is to insure the parties against situations in which foresight was unreasonable and where it would only be fair to find a satisfactory allocation of losses incurred as

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166. It was repeated at various occasions that the doctrine of performance operates within very narrow confines and must not be extended. See, e.g., *J Lauritzen AS v. Wijsmuller BV*, [1990] 1 Lloyds Rep. 1, 8; *Robert Purvis Plant Hire Ltd. v. David Farquhar Brewster*, Alex Kinloch; *Brewster, The Firm of Alex Brewster & Sons*, [2009] CSOH 28, para. 13.

167. For a discussion of the doctrine of frustration, see MCKENDRICK, *supra* note 29, at 308-23; PEEL, *supra* note 29, at 924-90; W. Kotzur, *Termination of Contracts—Frustrated Parties*, 13 J. INT’L BUS. & L. 345-47 (1998). For an interesting law and economics approach to the subject matter of frustration, see L. Anderlini, L. Felli & A. Postlewaite, *Courts of Law and Unforeseen Contingencies*, 23 J. OF L., ECON. & ORG. 662-84 (2007).

168. Frustration can only be invoked as a ground for termination of the contract, where the circumstances fundamentally changed the nature of performance. The mere fact that the performance becomes more burdensome is not sufficient to justify termination of the contract. This is also what Lord Simon held where he stated:

*The suggestion that an ‘uncontemplated turn of events’ is enough to enable a court to substitute its notion of what is ‘just and reasonable’ for the contract as it stands, even though there is no ‘frustrating event’, appears to be likely to lead to some misunderstanding. The parties to an executory contract are often faced, in the course of carrying it out, with a turn of events which they did not at all anticipate—a wholly abnormal rise or fall in prices, a sudden depreciation of currency, an unexpected obstacle to execution, or the like. Yet this does not in itself affect the bargain they have made. If, on the other hand, a consideration of the terms of the contract, in the light of the circumstances existing when it was made, shows that they never agreed to be bound in a fundamentally different situation which has now unexpectedly emerged, the contract ceases to bind at that point—not because the court in its discretion thinks it just and reasonable to qualify the terms of the contract, but because on its true construction it does not apply in that situation.*

*British Movietonews v. London & Dist. Cinemas* [1952] AC 166, 187; see also *Lauritzen AS v. Wijsmuller BV*, [1990] 1 Lloyds Rep. 1, 8 (“*A frustrating event must be some outside or extraneous event*”); *Nat’l Carriers Ltd. v. Panalpina (Northern) Ltd.*, [1981] AC 675, Lord Simon of Glaisdale at p. 700 F-G (“*so significantly changes the nature (not the expense or onerousness)*”); *CTI Group Inc. v. Transclear SA*, [2008] Bus. L.R. 1729, 1736.

169. *Davis Contractors v. Fareham UDC*, [1956] AC 696, 728. That test has been applied in numerous cases, such as for instance: *National Carriers Ltd v. Panalpina (Northern) Ltd.*, [1981] AC 675, 700; *J Lauritzen AS v. Wijsmuller BV*, [1990] 1 Lloyd’s Rep. 1, 8; *Gryf-Lowczowski v. Hinchingbrooke Healthcare NHS Trust*, [2006] I.C.R. 425, 437.

a result of changed circumstances. This was clearly set out by Lord Justice Bingham when he stated:

The doctrine of frustration was evolved to mitigate the rigour of the common law's insistence on literal performance of absolute promises. (...) The object of the doctrine was to give effect to the demands of justice, to achieve a just and reasonable result, to do what was reasonable and fair, as an expedient to escape from injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances.<sup>170</sup>

Or as Lord Simon put it in the House of Lords' Panalpina case, the doctrine of frustration was developed "*as an expedient to escape from injustice*".<sup>171</sup> Alternatively, the courts could also excuse the parties from fulfilling their obligations under the agreement when doing so would run contrary to the public interest. That is the case of frustration for purpose of illegality. The leading case in this regard is the House of Lords' Fibrosa decision where a war superseded the parties obligations to perform under the contract.<sup>172</sup> A second limitation to the doctrine of frustration is the requirement of unforeseeability. The event that occurs after the conclusion of the contract and that frustrates the contract, should not have been foreseeable. There is considerable ambiguity as to what constitutes 'unforeseeability'.<sup>173</sup> Thirdly, a party cannot rely on frustration as grounds for terminating a contract when the problem might be attributed to the party's own conduct or that of a person for whom he is responsible.<sup>174</sup>

#### *E. Other Reflections of Fairness and Honesty*

There are various other rules which reveal the law's concern with fairness and honesty that will not be elaborated on in this Paper. These rules all seek to achieve a compromise between freedom of contract and the *emptor caveat* rule on the one hand, and the concern for the moral imperatives reflected in the concept of good faith and fairness on the other hand. An example is the restricted acceptability and legality of exclusion clauses.<sup>175</sup> Although the courts do not go as far to accept the inequality of bargaining power to remedy the unfairness stemming from

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170. Lauritzen AS v. Wijsmuller BV, [1990] 1 Lloyds Rep. 1, 8.

171. Nat'l Carriers Ltd v. Panalpina (Northern) Ltd., [1981] AC 675, 701.

172. Fibrosa Spolka Akcyjna Appellants v. Fairbairn Lawson Combe Barbour, Ltd. Respondents, [1943] A.C. 32.

173. On what constitutes foreseeable events, see PEEL, supra note 29, at 963-67.

174. *Id.* at 967-76.

175. On exclusion clauses, see MCKENDRICK, supra note 29, at 223-55.

the execution of a contract, the law does place limits upon a party's potential to exploit the other party economically or in any realm in which its weakness is manifest. This balance seeking exercise works in two directions. It not only serves the interests of the weaker party, it also concerns itself with the interests of the ('stronger') party, who in all good faith, deals with a legally incompetent counterparty. An example can be found in the limits placed upon the protection of parties that are incapable of contracting.<sup>176</sup>

#### IV. QUANTIFIABILITY OF THE ROLE AND MEANING OF GOOD FAITH

From a functional comparative perspective it is clear that English law is not at all heedless of considerations of good faith and fairness. In all the cases set out here above we see though that the courts have limited their intervention to rather exceptional cases. This dogmatic analysis demonstrates that the English courts have not totally overcome their aversion to a general doctrine of good faith, though they have accepted a limited application of good faith as a rule. A question that this Paper has yet to answer is whether the limited acceptance of good faith as a rule as well as the movement towards more "*alignment with the expectations associated with good practice*"<sup>177</sup> (*i.e.* good faith as an underlying principle of diverse rules) has in any way changed lawyers' outlook on the role that good faith can play in contract law as a general *principle* of law. In other words, is there a demonstrable relationship among these various trends?

From past movements, one would venture to answer this question positively. In an article written in 1998 Brownsword noted that until the late 1980s, academics and textbook writers never addressed the topic of good faith in contract law, nor was it openly pleaded or addressed in litigation. The only references to it were negative references to 'bad faith' that occurred in judicial opinions.<sup>178</sup> Brownsword pointed out that this has changed since the late 1980s onwards under the influence of—amongst other things—European directives introducing some notion of good faith.

Now, it is one thing to suggest intuitively that this trend must have persevered over the last ten years. It is another thing to also substantiate in a scientific fashion that England is moving towards the acceptance of a general principle of good faith. This begs the question of whether there

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176. *Id.* at 348-54.

177. R. Brownsword, Positive, Negative, Neutral: The Reception of Good Faith in English Contract Law, in Brownsword et al., *supra* note 71, at 39.

178. *Id.* at 13-14.



überhaupt is a method to measure a change in attitude or conception of a legal notion. Legal science is not used to drawing inferences from ‘measurements of reality’ as do other social sciences. Is it desirable to resort to figures and numbers to develop and establish a legal proposition, and in other words to try and ‘quantify’ the law?

The value of quantitative research in particularly *comparative* law is highly debated.<sup>179</sup> Siems for instance rightly pointed to the limits of the numerical research method for comparative legal studies.<sup>180</sup> When comparing different legal systems, one has to be aware of the terminological and functional differences among legal rules and concepts. Siems moreover suggested that any statistical evidence that results from this method might deceptively lead to a distorted image of the true significance and role of a specific rule in the compared legal systems. I agree that the functional comparative method requires considering a variety of factors that cannot be expressed in numbers only.

One must therefore pose the question whether motives other than the satisfaction of a scientific hunger for proof or the question for a methodological grip on an otherwise unquantifiable issue alone can justify quantitative research. I would argue that the numerical approach runs contrary to the essence of functional comparative research. The comparative legal research method is *in se* content based. It departs from and looks for the *meaning* of a concept as defined by its function and role in a particular legal system. Capturing the meaning of a term—or the evolution of its meaning—in quantitative indicia would be as elusive as “*dancing about architecture*”.<sup>181</sup> A quantitative methodology may, however, be useful to give a mere indication on the accuracy of a proposition.

Numerical data may support a *dogmatic*—rather than a functional—analysis of the relevance and use of good faith in the English legal system. At the very least, it will indicate the direction in which this notion is developing. Quantitative research could reveal the number of times a good faith clause is inserted in commercial contracts; on the percentage of cases in which barristers invoke the application of the good faith rule/principle before the courts; or on the extent to which law books devote attention to the notion of good faith. These three issues were the

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179. For a glimpse of this discussion, see M. Siems, Numerical Comparative Law: Do We Need Statistical Evidence in Law in Order To Reduce Complexity?, 13 *CARDOZO J. INT’L COMP. L.* 521-40 (2005).

180. *Id.* at 531-32.

181. The absurdity of such an attempt was raised by Elvis Costello with regard to writing about music: “*Writing about music is like dancing about architecture. It’s a really stupid thing to want to do.*”

subject matter of the research I conducted in July-August-September of 2008. Unfortunately only the third survey yielded some substantial and valuable *quantitative* data.<sup>182</sup>

This third leg of my empirical research aimed at establishing whether there has been a perceptible increase in attention to the notion of good faith in *English contract law handbooks* over the past 20 years and whether potentially there is a (probabilistic) relationship between such an increase and the rising number of good faith rules being implemented in English contract law. In other words, I examined whether the variable 'time' affected the outcome variable of 'number of pages' dedicated to the principle of good faith on the one hand, and the number of pages on good faith in the context of unfair terms in consumer contracts on the other hand. I did not count the number of pages on good faith as a rule and, for example, omitted the number of pages on 'utmost good faith'<sup>183</sup>.

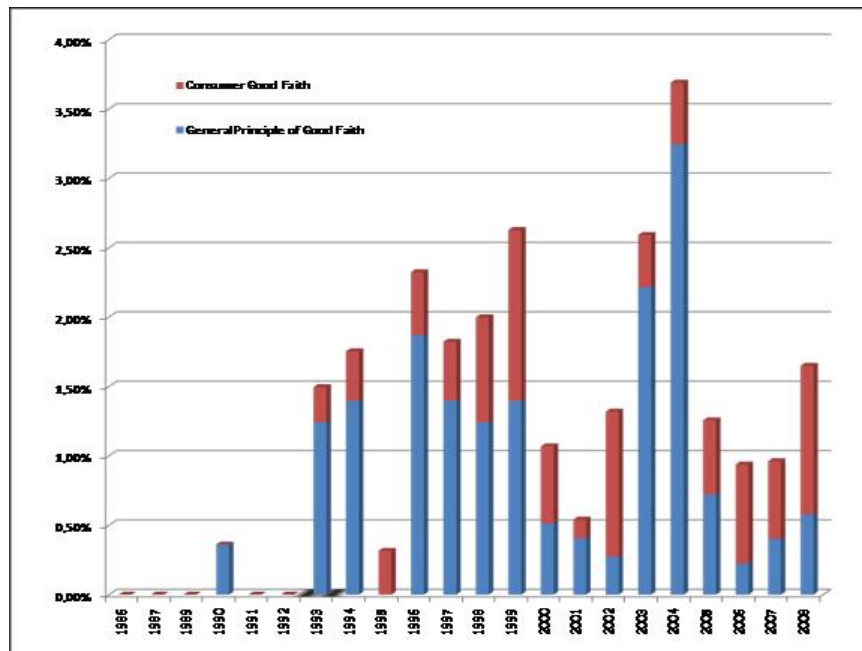
I gathered the necessary information by perusing editions since 1986 of all contract law handbooks present in the Oxford Bodleian Law Library. I started by looking at the keyword indices that were available in all books. Then I read and counted the number of pages that dealt with the first (good faith as a principle) and second (good faith as a rule in consumer contracts) outcome variable. These respective numbers were divided by the number that equals the total amount of pages of the book. That fraction showed me the percentage of space the book consecrated to either good faith as a principle and good faith in connection to unfair terms in consumer contracts. Finally, I calculated the average number of pages in all books published in one year. This exercise resulted in the following chart. Note that the attributes of the first variable of time vary from 1986<sup>184</sup> until 2008.

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182. I sent a questionnaire with questions regarding the first two issues to barristers and solicitors. The response from the solicitors was quasi inexistent. The response I got from barristers was helpful and interesting though not numerous enough to be able to draw valuable quantitative inferences. The barristers' answers were, however, very useful as qualitative input.

183. Although it was remarkable that more attention is paid to this topic in the recent contract law handbooks.

184. This is the year in which the 'Council Directive 86/653 on the coordination of the laws of the Member States relating to self-employed commercial agents' was issued. Article 3 of this Directive provided for a good faith obligation for commercial agent.



The results as shown here confirm the alternative hypothesis that was set out at the beginning of my research. It is naturally logical that the mentioning of good faith in relation to unfair terms in consumer contracts would only start as from about 1993 onwards. A more remarkable finding is that since the notion of good faith was introduced as a rule on a European level in the Directive 93/13 and implemented in the English legislation through the Unfair Terms in Consumer Contracts Regulations in 1994, the principle of good faith was mentioned in the majority of the contract law books that were scrutinized in my research. The adoption of the ‘Council Directive 86/653 on the coordination of the laws of the Member States relating to self-employed commercial agents’ in 1986 had no such impact on the content of contract law text books.<sup>185</sup> It is important to mention as well that 1992 was also the year in which the House of Lords decided upon the role of good faith in the case of *Walford v. Miles*.

It is perhaps too daring to rely on these inferences to definitively demonstrate that English attitudes toward the principle of good faith have evolved substantially in recent years. One ought to heed Oscar Wilde’s warning<sup>186</sup> and avoid the seduction of oversimplification. These data, at

185. This Directive was implemented in English legislation in 1993.

186. Oscar Wilde said: “*The truth is rarely pure and never simple.*”

best, can only point to the potential for a paradigm shift in academic thought. The way in which *scholars* look at good faith does not necessarily reflect or influence the way *practicing lawyers* go about employing the concept of good faith in their work. I trust that of course very few readers would fall into the trap of this ‘exception fallacy’. It is, however, not beyond the pale to suggest that correlations between legal practice and academic output exist and are important.

Moreover, the results of this research must be understood against the background of a number of mitigating factors that affect the interpretation of numerical data. First of all, the reflections on the general principle of good faith in the scrutinized law books usually consist of a reference to this principle as understood in continental Europe together with an analysis of the role that good faith does (not) or might play in England. The fact that a book covers good faith, does not say anything about the point of view it issues on good faith in England. Also, the authors of these handbooks have changed over the years and a number of them are comparative jurists, rather than English lawyers concerned only with the English common law tradition. Moreover, contract books are not revised and reissued annually. Therefore, one has to be careful not to get a distorted view from the yearly assessment of the evolution of the first and second outcome variables. Also, the values of the outcome variables depict an average of possibly several different law books. Certain authors (e.g., E. McKendrick) have long explored the meaning of the principle of good faith in their handbooks. The percentages relating to these books may bump up the average and disguise that some books still do not report on the possibility of good faith as a general principle. The chart for instance does not show that the last edition I found where no mention was made of the existence of good faith as a general principle dated from 2005.

For these reasons, I think it is fair to conclude that these numerical data only allow us to sketch in broad outlines the direction in which the academia’s perception of good faith is developing. Also, these results only have value for a dogmatic comparative legal analysis of good faith.

#### CONCLUSION: GOOD FAITH AS A RULE OR PRINCIPLE—QUO VADIS?

Good faith is merely “*the skin of a living thought*” and can thus hardly be said to be “*transparent*” or “*unchanged*”.<sup>187</sup> Although this is

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187. Paraphrasing O. W. Holmes who said: “A rule is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances and time in which it is used.”

probably true for any legal notion, it is certainly the case for the notion of good faith in English law. The objective of this research effort has been to examine whether and how this 'living thought' evolved into its contemporary meaning and function. This evolution has been explored in the context of the Europeanization (and globalization) of commercial law and the mounting influence of continental legal thought and practice on English law.

An important conclusion is that good faith has always played a certain role in English law, although not necessarily in an explicit fashion. At various stages of the contracting process the courts and the legislature created specific *rules* that provided a minimum standard permitting the invocation of unfairness or bad faith, although not necessarily in those words. The majority of these rules does *not expressly* refer to good faith and are rather assessed on an objective basis. However, a concern for fairness, honesty or reasonableness obviously runs through these legal mechanisms. English law has also designated certain contractual relations as being subject to an *explicit*, though qualified duty of good faith. Good faith can thus be understood as a value that implicitly or explicitly contributes to the formation of rules and which defines the boundaries of contractual freedom. Its particular meaning and influence, moreover, vary according to the context in which it is used. Today these implicit or explicit duties very often involve requesting that parties refrain from behaving in a certain way instead of imposing a positive duty.

Good faith has never taken root, however, as a general *principle* in England and now only interferes with the binding nature of contracts in a restricted fashion. In other words there seems to be lesser reluctance to the idea of good faith as such in England, but there is a persistent aversion to expressly engaging in vague and poorly defined applications of the general principle of good faith. This may be surprising for Civil Law lawyers, though it is not for a Common Law trained lawyer. The dividing line between a rule and a principle essentially mirrors the differences that distinguish the Common Law tradition from the Civil Law legal culture.

The English Common Law system, for instance, relies on inductive reasoning to unearth rules applicable to particular cases. In other words, a rule that was previously found fit to resolve a particular analogous case will again be applied to deal with distinct but comparable situations. English law has developed over the centuries by deducing rules of law

from cases that had accumulated over the years. There is *prima facie*<sup>188</sup> a structural reluctance to adopt overarching, general *principles*. The Civil Law system, on the contrary, employs a deductive method of reasoning, and uses abstract principles as the foundation for practical findings. The Civil Law system employs ‘codes’, while in England there are no civil or commercial codes. Thus Common Law resolves issues starting from a particular situation and rule, while lawyers operating in a Common Law framework work with an abstract rule/principle that is applied to a particular situation.

This distinction is also reflected in the previously discussed methods of statutory interpretation. The express limits on the powers of the judiciary to interpret the law in English courts reflect the impact that English courts have had on the development of English law. English court decisions themselves are a source of law. The courts’ decisions have precedential value. This differs from continental practice as courts in those systems only interpret the statutory rules of law and apply them to specific cases. Their decisions are not binding or even relevant to those not participating in the particular case. The decisions of the English courts, however, can have a wider and more systemic impact with implications for litigants in a broad range of cases. This explains the traditional mutual suspicion between judicial and legislative authorities in England. The courts’ lawmaking power is significantly more far-reaching though probably for that reason also more tightly restricted. Courts are not endowed with the power to freely find new rules on the basis of broad principles or through interpretation methods that accord powers to the courts that permit them to fill in the legislature’s presumed intentions.

The significance of good faith as either a rule or a principle obviously corresponds to the legal culture in which it operates. The issue of whether Common Law and Civil Law traditions might converge on this specific point is complex and the answer to the set of riddles it poses is accordingly elusive. It is, however, undeniable that the English law’s outlook on good faith has undergone a subtle change of outlook in the past ten years. My analysis suggests that the English courts and academia are ever more open to the *notion* of good faith, are increasingly

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188. This does not mean that there is a lack of underlying principles which can be discerned from the systematized way in which the courts rule based on precedents. Van Hoecke states that “because of the binding character of precedents, judicial decisions in the common law are perhaps more systematized than on the continent”. He refers to the case of *White v Jones* where the House of Lords is fitting in a new principle within the system of previously accepted principles of common law. M. VAN HOECKE AND F. OST, *HARMONIZATION OF EUROPEAN PRIVATE LAW* 16 (Oxford, Hart 2000).

inclined to apply rules guided by that notion, and are increasingly interested in exploring the implications of the *principle* of good faith. The actual effect on legal practice has heretofore been limited and somewhat difficult to measure. The arguments on good faith raised before the courts oftentimes constitute only a peripheral element of court rulings. Only a handful of cases unambiguously—and thus not merely as an ‘obiter dictum’—deal with the argument of good faith. A relatively small number of respected Justices have endeavored to draw attention to the fact that the application of a general principle—such as the one on good faith—might be useful and even necessary in English Law. It remains to be seen, however, whether this intimation of change might eventually evolve into a general movement to elevate good faith to the status of an express general principle.