

A Discussion of the Legal Principle of Good Faith in Contract Law and Its Connection to European Union Law

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1 Introduction

The principle of *good faith* along with its sole definition in contract law and in commercial contractual transactions have a ranging degree of applicability and acceptability.

To the western side of the Atlantic Ocean, the United States is the only common law country that has included good faith into its statutory regime. The textual ideology of the *conceptualized legal principle of the term, good faith*, can be found in section 205 of the Restatement (Second) of Contracts, as adopted by the American Law Institute in 1979 and published in final form in 1981, which provides as follows:

“§205. Duty of Good Faith and Fair Dealing. Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”⁶¹

Additionally, there exists the obligation of good faith dealings in general as contained pursuant to the Uniform Commercial Code (UCC)*. Section 1-203 of the UCC provides as follows:

“Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement. Good faith is defined at Section 2- 103(j) as ‘honesty in fact and the observance of reasonable commercial standards of fair dealing.’⁶² This is pretty much the same as what is held by common law, which ‘imposes a duty of good faith and fair dealing upon the parties in performing and enforcing the contract.’”⁶³

Further, Section 3-103(4) of the UCC defines good faith as “honesty in fact and the observance of reasonable commercial standards of fair dealing.”⁶⁴

To be best categorized, it has come to be understood, that from these above two most commonly used definitions, good faith is to be viewed as having two essential elements or aspects:

“(1) Adherence to reasonable commercial standards of fair dealing; and (2) Faithfulness to the agreed common purpose of the contract and to the reasonable expectations of the parties arising from it”.⁶⁵

To the eastern side of the Atlantic Ocean, the term good faith exists rather as an *adopted fundamental principle*, often appearing in the context through the interpretation of legislation and without specific definition. The Vienna Convention on Contracts for the International Sale of Goods 1980 (CISG) has adopted the principle of good faith. The Vienna Convention of 11th April 1980 on international sale dictates that pursuant to the Convention:

“...particular attention must be paid to the ‘observance of good faith in international trade’. Good faith is thus defined as a guideline for the interpretation of the whole

⁶¹ Restatement (Second) of Contracts, Section 205.

⁶² <http://www.saylor.org/books/p.571>

⁶³ <http://www.saylor.org/books/p.841>

⁶⁴ UCC, Section 3-103(4) * **The Uniform Commercial Code (UCC)**, first published in 1952, is one of a number of uniform acts that have been put into law with the goal of harmonizing the law of sales and other commercial transactions across the United States of America (U.S.) through UCC adoption by all 50 states, the District of Columbia, and U.S. territories.

⁶⁵ MacQueen, H.L., “Good Faith in Contract and Property Law” (1999).

Convention: the interpreter 'must ensure compliance with good faith in international trade.'⁶⁶ This disposition undoubtedly introduces a certain flexibility in conventional rules.⁶⁷ Good faith thus appears with a moral connotation, as a term used to regulate business life. If the freedom of the contracting parties is essential to a market economy, the freedom of some must coexist with the freedom of others: good faith presents itself as one of the regulating principles able to 'achieve this coexistence. And that under the CISG, Article 7, it is declared as follows, that: "Regard is to be had...to the observance of good faith in international trade."⁶⁸

The general principles that are referred to in the CISG contain the following concepts, such as:

"Uniformity; Good faith; Full compensation; Equality between buyer and seller; Respect for different backgrounds; Contractual commitment; Forthright communication and; Forgiveness of human error."⁶⁹

But query, why is there the need to construct the principle of good faith as a tool of legal intervention for the purpose of achieving the better performance and enforcement of contracts in today's international commercial trading markets? To that, a response by one legal scholar (Juliet P. Kostritsky) has argued that,

"Legal intervention in enforcing contracts is economically justified because it helps to enhance first best outcomes between contracting parties in an economically imperfect world. The imperfections that make the world economically inefficient are structural in nature and are comprised of the following: (1) uncertainties relating to externalities, adverse selection, and moral hazard; (2) contracting parties' human tendencies toward opportunism; and (3) sunk[en] costs that are lost in the event of opportunistic behavior during the course of contract performance (these sunk[en] costs might also be referred to as reliance costs)."

The author further argues that,

"in light of such structural impediments to efficiency, legal intervention required to deal with those impediments is ultimately less costly than private strategies that parties might otherwise use."⁷⁰

⁶⁶ Heuze, V., "La vente internationale de marchandises", LGDJ 2000, n°91.

⁶⁷ Ibid.

⁶⁸ <http://www.saylor.org/books/p.572>.

⁶⁹ Reiley, E., International Sales Contracts. The UN Convention and Related Transnational Law, p.75.

⁷⁰ Kostritsky, Juliet P. Kostritsky, University of Wisconsin Law School, Symposium on "Freedom from Contract", Wis L. Rev., 323, 324-30.

Following up, many other developed international uniform law documents also make reference to the idea of good faith in contract law. The UNIDROIT Principle of International Commercial Contracts as well as the European Principles of Contract Law incorporated articles of good faith into their frameworks, recognizing that boundary borders have been opened-up as a result of globalization, and it has become necessary to generally comprehend that:

“The court system can no longer be regarded as an institution operating exclusively behind national walls. The system now functions increasingly in an international environment and must respond to that circumstance.”⁷¹

Interest in good faith as a matter of contemporary law is twofold. One as to the function it performs and two, the reason behind its vagueness necessitating the need for adapting a framework for it to exist as a defined term, and not just as an abstract notion.

In some instances, the term good faith appears as in the context of the interpretation of legislation while at other times as an integral part of a factual situation. When good faith, as expressed in the context of legislative interpretation and in texts, is clearly mandated and defined, it serves to ensure a certain flexibility of interpretation and to prevent the issue of any silent doubt. Therefore, having the intended purpose of being a textual principle subject to consistent interpretation, this allows the application of the concept of good faith to apply to such legal interests as: 1) international treaties; 2) international texts which seek especially to promote good faith as an understood standard of behavior; and 3) contractual relations which have the aim of promoting a certain ideal of justice and fairness within said relationship.⁷²

Furthermore, the principle of good faith permeates through several ideological concepts in the law. The doctrine appears as a conceptualized, generally implied obligation in the law of contracts, as well as having been codified, legislatively or statutorily, to spheres well beyond, such as in the areas of private local law and private international law. It has managed to become part and parcel in the developments of both international and national law, in contemporary American and European communities, either in extensive or limited form.

Moreover, in addition to the express terms of a contract, most contracts today, depending on the jurisdictional venue indicated for the interpretation of the contract, contain an implied covenant of good faith and fair dealing. As an objective concept, good faith is a tool found to exist in contractual relationships and to create a flooring of equal bargaining power in a world of autonomous dealings and negotiations.

As a subjective concept, good faith can be visualized as a manner of creating the perception of *fairness*. And in some instances, as a practical concept, good faith is a factual matter:

⁷¹ Gleeson M., “The State of the Judicature”, *The Law Institute Journal*, 74.

⁷² http://www.legiscompare.fr/web/IMG/pdf/13._CH_5_Good_faith.

“Good faith is therefore usually said to be an open norm, a norm the content of which cannot be established in an abstract way, but which depends on the circumstances of the case in which it must be applied, and which must be established through concretisation. Most lawyers from a system where good faith plays an important role, will therefore agree that these differences in theoretical conception do not matter very much (...) What really matters is the way in which good faith is applied by the courts: the character of good faith is best shown by the way in which it operates.⁷³ ...More than a rule, good faith is also used as a standard,⁷⁴ a general principle according to some⁷⁵, or a norm, a rule, a maxim, a duty, an obligation according to others.”⁷⁶

2. The Definition of Good Faith in Contract Law

2A. What is the Definition of Good Faith in Contract Law?

Before embarking on any dialogue of a legal concept in its various contextual settings, it is first best to adapt a standardized definition from which any discussion can proceed.

According to the ninth (9th) edition of Black’s Law Dictionary, several definitions attached to the term good faith can be defined as:

“A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one’s duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.”⁷⁷

Further extension of the term of good faith can be understood to be:

“The phrase ‘good faith’ is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes

⁷³ Hesselink, M.W., “The Concept of Good Faith” p.27 International, Third fully Revised and Expanded edition, 2004, p.474.

⁷⁴ Jacques, Ph., p.28, n°160.

⁷⁵ See. Jauffert-Spinos, C. On the nature of good faith as general clause, general standard or principle, “Théorie et Pratique de la Clause Générale en Droit Français Et Dans les autres Systèmes Juridiques Romanistes”, in *General Clauses and Standards in European Contract Law. Comparative Law, EC Law and Contract Law Codification*, S. GRUNDMANN, D. MAZEAUD eds., Kluwer Law International, 2006, p. 23.

⁷⁶ Hesselink, M.W., *op. cit.* p. 473, notes 12-20.

⁷⁷ Black’s Law Dictionary, 9th ed.

faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances." ⁷⁸

In addition to the definitions developed above, the contextual perception of a good faith concept is viewed as:

"Good faith is an elusive idea, taking on different meanings and emphases as we move from one context to another - whether the particular context is supplied by the type of legal system (e.g., common law, civilian, or hybrid), the type of contract (e.g., commercial or consumer), or the nature of the subject matter of the contract (e.g., insurance, employment, sale of goods, financial services, and so on)." ⁷⁹

The Uniform Commercial Code defines the term good faith as:

"honesty in fact in the conduct or transaction concerned. Fair dealing may require more than honesty (e.g., you cannot act in a way that is contrary to the spirit of the bargain, even if you give the opposing party notice of your actions). Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party." ⁸⁰

Open-ended generalizations of the term good faith have included such abstract definitions as:

Good faith is an absence of intention to harm a legally protected pecuniary interest." ⁸¹
Good faith performance occurs when a party's discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation-to capture opportunities that were preserved upon entering the contract, interpreted objectively." ⁸²
"Good faith and fair conduct consists of action "according to reasonable standards set by customary practices and by known individual expectations." ⁸³

2B. What is Good Faith as a Legal Principle in Contract Law?

There are many countries where the concept of good faith is found to exist as a concept in their civil code, such so that it applies to all contracts (whether expressly included in a contract or

⁷⁸ Restatement (Second) of Contracts § 205.

⁷⁹ Brownsword, R., Concept and Context 1, 3.

⁸⁰ UCC, Section 1- 201.

⁸¹ Burton, Breach of Contract, supra note 7, at 372-73 n.17.

⁸² Id. at 373.

⁸³ Holmes, 39 U. Pitt. L. Rev. 381, 388-89, note 13, at 452.

not). Good faith, for example, for the European Court of Justice has been referred to as a “principle of civil law”⁸⁴ and the Common European Sales Law includes a definition of “good faith and fair dealing” as “*a standard of conduct characterised by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question*”.⁸⁵

For many countries, good faith (*bona fide*) is implicit within all contracts and that the parties are expected to act in a manner defined by good faith. For example, if the seller of a "mustang" knows that the buyer thinks he is purchasing a car, but secretly intends to sell the buyer a horse, the seller is not acting in good faith and the contract will not be enforceable. It usually implies an amount of trust that the parties are acting without any hidden motives. The opposite is **mala fides** - in bad faith.

2C. The Principle of Good Faith as an Implied Covenant

As a principle in contract law, most countries decree or maintain regard for the principle of good faith to exist as a type of implied covenant in that “every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement,”⁸⁶ and that, “*courts possess a considerable amount of discretion when applying the covenant*”,⁸⁷ as there is “*no bright line rule or single definition*”,⁸⁸ as to the term of good faith.

1 Common descriptions of the covenant can require a party to a contractual relationship to refrain from “*conduct that prevents the other party from receiving the fruits of the bargain*.” Further, that a party can be found to be liable for a breach of the covenant when, “*their conduct frustrates the overarching purpose of the contract*.”⁸⁹ And finally, that absent an express provision, the law will imply a contract between the parties to “*perform those things that according to reason and justice they should do in order to carry out the purpose for which the contract was made and to refrain from doing anything that would*

⁸⁴ C-489/07 Messner v Krüger [2009] E.C.R. I-7315

⁸⁵ [http://www.eversheds-sutherland.com/global/en/index.page/Article 2/Common European SalesLawCom/2011/0635final-2011/0284](http://www.eversheds-sutherland.com/global/en/index.page/Article%20Common%20European%20Sales%20Law%20Com/2011/0635final-2011/0284) (COD)

⁸⁶ www. Internet 2014-02-12 Stanley-Ronon pdf Good Faith, Case Compendium.

⁸⁷ Ibid. supra.

⁸⁸ Ibid. supra.

⁸⁹ Ibid. supra.

destroy or injure the other party's right to receive the fruits of the contract.”⁹⁰

2D. Good Faith as a Tool of Party Self-Enforcement to Achieve Reasonable Expectations

As a tool of enforcement, good faith places an obligation upon the parties to act in a certain manner and that the obligation of good faith and fair dealing extends to the:

“assertion, settlement and litigation of contract claims and defenses. That this obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one’s own understanding, or falsification of facts. It also extends to dealings that are candid but unfair. Examples include: taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without a legitimate commercial purpose.”⁹¹

Fundamentally, the doctrine of good faith, as a principle in contract law, is invoked to protect and fulfill each party’s **reasonable expectations**, so as to:

“imply contract terms when the party asserting the implied covenant proves that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that the asserting party reasonably expected.”

Further, that the principle of good faith, *“...requires that [each party to a contract] act in a way that honors the [other’s] reasonable expectations.”⁹²*

Additionally, that in stating the test for determining if an implied covenant of good faith has been breached, decisional law has stated:

“a party exercising its right to use discretion in setting price under a contract breaches the duty of good faith and fair dealing if that party exercises its discretionary authority arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits under the contract.”⁹³

⁹⁰ Ibid. supra.

⁹¹ www. Internet 2014-02-12 Stanley-Ronon pdf Good Faith, Case Compendium.

⁹² Ibid. supra.

⁹³ Ibid. supra.

And finally, further decisional law has specified that the: *“implied covenant of good faith...is a principle for the courts to harmonize the reasonable expectations of the parties with the intent of the traders and in accordance with the terms in their contract.”*⁹⁴

The rationale for having a good faith requirement takes the view that the general requirement of good faith is: *“a means to “justice and to justice according to law.”*⁹⁵ The good-faith requirement serves to offer:

(1) "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party," and (2) "community standards of decency, fairness or reasonableness."⁹⁶

2E. Factors Influencing the Ambit of Good Faith

Not to serve as an all-inclusive list, there exists a combination of contractual, relational and motivational factors that go to influence as to when the court should apply the legal principle of good faith in contracts. Some of the factors are:

1. the type of claim before the court;
2. the sophistication of the parties*;
3. the motivations of the parties, whether found to be spiteful or malicious, containing bad motives or intention, thereby serving as proof of **bad faith****;
4. the complexity and length of the agreement***

⁹⁴ www. Internet 2014-02-12 Stanley-Ronon pdf Good Faith, Case Compendium.

⁹⁵ Summers, 54 VA. L. Rev. 195/Summers, Good Faith, supra note 5, at 198.

⁹⁶ Restatement (Second) of Contracts § 205, Comment a (1979).

* **Sophistication of the parties:** “means that the more sophisticated the parties, the less likely the court will invoke the legal principle of good faith, since sophisticated parties are typically represented by counsel, have significant experience in the subject matter of their agreements and are likely to have negotiated more thoroughly than unsophisticated parties, and that basically, courts tend to find that sophisticated parties “should have known better” and try to enforce the express terms of their agreements.”

** **Bad faith:** “evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.”

*** **General rule:** the more complex the agreement, the less likely a court is to apply the legal principle of good faith.

3. The Concept of Good Faith as a Contractual Obligation Pursuant to European Union (EU) Law – PECL – CISG

Having first discussed the various definitions given to the term of *good faith*, as well as some of the general principles in contract law attributed to good faith, it is now necessary to furnish a definition as to what is meant by the terminology *European Union Law*, and then to provide a discussion as to the extent of its specific applicability.

Basically, “*European Union Law is a system of rules operating within the member states of the European Union.*”⁹⁷ Moreover, one general definition for European Union Law is as follows:

*“European Union law is a body of treaties, law and court judgments which operates alongside the legal systems of the European Union's member states. Whenever there is a conflict between EU law and national law, [generally] EU law takes precedence over national law and is binding on all national authorities. The European Commission is the institution responsible for ensuring EU law is applied throughout all member states.”*⁹⁸

As to contract law, European Union Law has been developed in accordance with the *Principles of European Contract Law (PECL)*. As its main goal, the PECL is an attempt to create a reference guide on uniform legal principles in the development of trans-national legal systems.

In its broadest interpretation, the PECL are a “*set of general rules which are designed to provide maximum flexibility and thus accommodate future development in legal thinking in the field of contract law.*”⁹⁹

Extending further, the purpose of the PECL is expressed as follows:

“The Principles of European Contract Law is a set of model rules drawn up by leading contract law academics in Europe. It [PECL] attempts to elucidate basic rules of contract

⁹⁷ <https://definitions.uslegal.com/e/european-union-law/>

⁹⁸ Ibid.supra.

⁹⁹ Lando O: Principles of European Contract Law, p. XXVII

*law and more generally the law of obligations which most legal systems of the member states of the European Union hold in common. The Principles of European Contract Law (PECL) are based on the concept of a uniform European contract law system and were created by the self-styled Commission on European Contract Law set up by Ole Lando ("Lando Commission"). The PECL take into account the requirements of the European domestic trade."*¹⁰⁰

As to the historical development of the PECL, the PECL was developed from an inspiration by:

*"...the United Nations Convention on Contracts for the International Sale of Goods (CISG) from 1980; however, they are a so-called **Soft Law**, such as the American Restatement of the Law of Contract, which is supposed to restate the Common Law of the United States. Therefore, the PECL does not represent a legally enforceable regulation: The term '**soft law**' is a blanket term for all sorts of rules, which are not enforced on behalf of the state, but are seen, for example, as goals to be achieved."*¹⁰¹

To reiterate, while the United Nations Convention on Contracts for the International Sale of Goods does not directly impose a good faith obligation, it does state that,

*"[i]n the interpretation of this Convention, regard is to be had to... the need to promote uniformity in its application and the observance of good faith in international trade."*¹⁰²

Taking into account, as previously stated, the denotative terminology attributed to the term *good faith*, the actual meaning of good faith lends itself to a myriad of definitions and a largesse of interpretations. As evident in the following declaration:

"It is universally recognized that the meaning of good faith poses a problem, as a definitive and precise meaning of the term is elusive. Even in Germany where good faith has been recognized for over one hundred years, and an extensive library of relevant cases exists, no actual definition of good faith has been established."¹⁰³ The drafters of the CISG also feared that a precise definition and application might not be possible.¹⁰⁴ However, despite such misgivings the CISG appears to have managed the inclusion of good faith without too much controversy."

¹⁰⁰ Ibid.supra.

¹⁰¹ Maastricht Journal of European and Comparative Law 5, 1998, p. 328-340.

¹⁰² CISG,1980, art. 7(1).

¹⁰³ Powers, P.J., 18 Journal of Law and Commerce p.333 -334.

¹⁰⁴ Ibid. supra p.337.

Beyond the various definitions given to the term good faith, it is worthy to examine the function that good faith plays in commercial contracts involving the European Union and its Member States. It is the opinion of those in the academic world that the function is twofold, thereby taking on a dual role. The opinion of scholars is that:

“Good faith therefore has two distinct functions or roles. First it must be used in interpreting the Convention. Secondly it regulates the behavior of the contractual parties... First good faith is examined as a state of mind, and secondly it is looked at as a principle found in various articles. It has been suggested that a definition of good faith is necessary for an understanding of article 7(1). However, it is argued that such a definition does not help to advance the application of good faith. Attempts have been made to define good faith. As an example,...it has been suggested that: the duty of good faith can be defined as an expectation and obligation to act honestly and fairly in the performance of one’s contractual duties. A certain amount of reasonableness is expected from the contracting parties.”¹⁰⁵

With that in mind, it begs to ask the question, that in light of the above, how does one apply such a definition to actual contractual obligations? And further questioning, as to how to apply good faith to the Convention, by imposing the requirement to act “honestly and “fairly”? These questions have so far been answered as follows:

“...good faith is a precondition, a holistic mind-set, which can be applied through concrete examples to the behavior of parties. It is more useful to look at approaches rather than definitions to explain the function of good faith. This is especially so as in many cases courts do not rely expressly on good faith. It arises often only through the interpretation of results. Not surprisingly, good faith can mean different things depending on the context of the contract and to that end, courts are merely required to ensure that the parties have genuinely adhered to the bargain which they entered into.”¹⁰⁶

Arguably, the issue of good faith only appears as an issue, when strange enough, there is only bad faith present in the contractual relationship on the part of the parties or both as stated:

“It is only if bad faith is present or good faith is explicitly excluded is there a need for a court to comment on the principle of good faith. Failure of a court to address the issue of

¹⁰⁵ [www.http: http://epublications.bond.edu.au/blr/](http://epublications.bond.edu.au/blr/) Bond Law Review Vol15, Issue 2, Article 13, p.220.

¹⁰⁶ [www.http: http://epublications.bond.edu.au/blr/](http://epublications.bond.edu.au/blr/) Bond Law Review Vol15, Issue 2, Article 13, p.238.

good faith thus implies that good faith was exercised.”¹⁰⁷

So where and when in the CISG, does the issue of good faith start to govern and play a principal role? The starting point is:

“to go back to article 4, which states that the CISG only ‘governs the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract’. Article 7(1) recognizes that good faith is applied in the interpretation of the totality of the CISG. The mandate is primarily directed to the judiciary to interpret the CISG in good faith. Such an interpretation covers the formation of the contract and the rights and obligations of the buyer and seller. Article 7 also creates a principle that good faith be found throughout the CISG such as in article. As such it is not only directed to the judiciary but also to the parties.”¹⁰⁸

From that point, enters the inquiry as to whether the mandate found in article 7 is sufficiently broad enough to extend beyond its specifics, by allowing the judiciary and the parties to the contract to place their reliance on the principles of good faith and to determine actual conduct in terms of good versus bad faith activities. Guidance to this question is directed from:

“There is no controversy in stating that article 7(1) urges the judiciary and the parties to the contract to observe good faith in international trade. The purpose of article 7(1) is to ensure that the Convention is interpreted in good faith. It therefore refers to the state of mind of those interpreting the Convention. The natural or normal state of mind when interpreting the Convention is with good faith. Article 8 of the CISG assists in this regard by prescribing that the subjective as well as objective standard is to be taken into consideration...It can be argued that there is no need to refer in the jurisprudence to article 7(1) as this article is applied to every case at hand in the ‘normal course’ of interpreting the CISG.”¹⁰⁹*

In specifically comparing the concept of good faith [and fair dealing], when interpreting contracts, we find that the instruments of the PECL (article 1.106) and the CISG (article 7), both provide that there must be regard given to the concept of good faith, as referenced by the citation below:

¹⁰⁷ Ibid. supra., p.221.

¹⁰⁸ Ibid. supra., p.222

* Article 8 states: For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent (or in not applicable, a reasonable person thereof) where the other party knew or could not have been unaware what the intent was.

¹⁰⁹ www.http: <http://epublications.bond.edu.au/blr/> Bond Law Review Vol15, Issue 2, Article 13, p.222.

“The concept of ‘good faith and fair dealing’ does not operate merely as a rule of interpretation of each PECL article. The duty of good faith, as this is embedded in PECL article 1.201, is mandatory on the parties. In contrast to article 7(1) CISG (or any other CISG provision), article 1.201 PECL imposes upon each party a positive duty of good faith and fair dealing in exercising its rights and performing its duties under the contract. The PECL Comments to article 1.201 not only refer to good faith as ‘a basic principle running through the Principles’, but also expressly state that ‘[g]ood faith and fair dealing’ are required in the formation, performance and enforcement of the parties’ duties under a contract, and equally in the exercise of a party’s rights under the contract.” ¹¹⁰

As we revert over to the role of the Vienna Convention, we find the following acknowledgement on the concept of good faith:

“On the other hand, the Vienna Convention does not contain any express provision that the individual contract has to obey the maxim of good faith. The text of article 7(1) CISG covers only the application of the Convention, rather than the parties’ rights and obligations and their exercise and performance directly. The wording was agreed upon only after lengthy deliberations and it was meant as a final rejection of more far-reaching proposals to apply the principle of ‘good faith and fair dealing’ to the obligations and the behavior of the parties themselves.” ¹¹¹

In summation of the above two instruments, it is worthy to mention that the concept of good faith has left its footprint in EU law, except with one noted distinction:

“Good faith occupies an integral position in the interpretation and supplementation of the CISG and the PECL. The concept of good faith is called upon in the CISG to guide the interpretation of the unified law text itself, whereas in the PECL it prescribes the behavior of the parties in every specific contract.” ¹¹²

4. The Evolution of Good Faith into a Pre-Existing Duty to Negotiate in Good Faith under European Union (EU) Law

The general principles underlying the concept of good faith, can be found in various stages

¹¹⁰ <https://cisgw3.law.pace.edu/cisg/text/peclcomp7.html> 3/33/Guide to Article 7

¹¹¹ <https://cisgw3.law.pace.edu/cisg/text/peclcomp7.html> 4/33/Guide to Article 7

¹¹² <https://cisgw3.law.pace.edu/cisg/text/peclcomp7.html> 6/33/Guide to Article 7

of the contract: the pre-contractual-negotiating stage, the contract-writing stage, the contract-interpretation stage, and if needed, the contract-enforcement stage. The standards to be embodied offer legal efficiency, certainty, and security, and further, reflect the moral values embraced by loyalty, honesty and respect, as well the commercial values of fairness, flexibility and reasonableness.

With regard to contract-writing and its thereafter stages, some of the following have been put forward as the obligations of good faith:

- *“to act honestly;*
- *to act reasonably;*
- *to act with fidelity to the bargain;*
- *to act reasonably and with fair dealing having regard to the interests of the parties; and*
- *to co-operate in achieving the contractual objects”.*¹¹³

In its legal development, good faith has evolved into a concept and generally accepted tenet, that in all commercial transactions and contracts, there exists a pre-existing duty, or in other words, a set of pre-contractual obligations on the part of the parties “during the diligence and negotiating stage(s)”,¹¹⁴ obliging them to negotiate in good faith.

This pre-existing duty on behalf of the parties to negotiate in good faith, carries with it the obligation that the parties to:

- *“disclose certain material information relating to the Target which is recognizably material for making the buyer’s decision to enter into a transaction,*
- *refrain from misleading the other party and*
- *keep the other party informed about circumstances which may change either party’s decision to enter into a transaction.”*¹¹⁵

Further, as a result of a breach of this pre-existing duty, the effect can be as follows:

“A breach of the obligation to negotiate in good faith may lead to a duty to re-instate the

¹¹³ Kiefel, Susan. “Contract, Good Faith and Equitable Standards in Fair Dealing”, 116 Law Quarterly Review 66, p.69.

¹¹⁴ Arnold, Rainer. “International Business Law”, Steinbeis ed., p.233.

¹¹⁵ Arnold, Rainer. “International Business Law”, Steinbeis ed., p.233.

*other party in the position it would have been in if negotiations had been conducted in good faith (practically resulting in a duty to pay damages)."*¹¹⁶

This pre-existing duty may find itself being directly carried over to the contract itself. *"In some instances, the parties enter into a pre-contract in a binding form and agree to negotiate in good faith a fully documented contract at a later stage."*¹¹⁷

5. Conclusion

In summary of the paper's conclusions, despite all discussions to the contrary, the evolution of *good faith* in EU Law still remains a principle without a definitive, precise and/or clear meaning, as it is yet subject and required to be submitted to continuous interpretation, although aided by defined relevant tools in which to measure the subjective and objective intent of the parties, as provided in the CISG, pursuant to its article 8. The concept of good faith exists as a recognized concept in today's EU Law as evidenced by the following ideas:

*"...there must be an awareness and recognition that an obligation of good faith is not only imposed on parties to a contract but that the obligation is also extended to the judiciary. In international conventions, an obligation to interpret the document in good faith is included and such an obligation can also be extended to the interpretation of a contract. After all, the CISG and other such instruments do interpret contractual obligations by giving meaning to a contract. Just because such an obligation is embedded in a statute does not exclude its extension, at least by analogy into common law."*¹¹⁸

The author Marietta Auer portrays the concept of good faith in contract law has typically having three dimensions and involving discussions of:

"first, a substantive dimension of justification of good faith duties in terms of, for instance, contractual ethics; second, a formal dimension concerned with its structure as a vague standard; and finally, an institutional competence dimension raising the question of judicial freedom and constraint in adjudication based on open standards such as good

¹¹⁶ Ibid. supra., p.233.

¹¹⁷ Ibid. supra., p.237.

¹¹⁸ Zeller, Bruno. Bond Law Review, Vol.15, Article13, p.25.

faith”.¹¹⁹ ...“controversies between an individualist ethics of freedom of contract and the opposing altruist value of interpersonal responsibility, between the danger of judicial arbitrariness and the demand for equitable flexibility, and, finally, between the legitimacy of judicial law making and the insistence on judicial restraint”.¹²⁰

For the future, it is the hope and aspiration of the modern commercial world to theoretically and practically incorporate, at least with some degree of legal certainty, basic principles of good faith, inclusive of such concepts of fairness, fair dealing and honesty when negotiating during the pre-contractual stage as well upon entering into and executing the contract itself and thereafter, so as to regard them as expected “duties” of the parties in a commercial transaction. *“Good faith is not only a rule for the interpretation of the Principles, but equally a norm integrating additional obligations and terms into the contract and restricting the exercise of contractual rights.”¹²¹*

By incorporating certain fundamental principles, the contractual responsibilities of the parties may be better understood and that both express and implied obligations can be effectuated with greater simplicity and transparency. Expectantly, the benefits of such further incorporation should extend to any ancillary duties that the parties may encounter, such as those stemming from non-performance and remedies as an example.

The doctrine of additional duties has been espoused by M. Hesselink in the form of four distinguishing main categories: *1. “duties of care, protecting the negative interest (extracontractual interests) of the other party; 2. duties of loyalty, protecting the positive interest (advantage of the contract itself) of the other party; 3. duties to co-operate; and 4. duties to inform.”¹²²*

All of the created EU lawmaking instruments are attempts to modify the inherent nature of contract law, as consisting only of a set of default principles and rules. It is the aim, hope, and aspiration of EU law to create as a standard of conduct, among contracting parties, of a cooperation of a long-standing nature, so that contracts are considered as to what is commonly referred to as **“relational contracts,”** which is regarded as:

¹¹⁹ Auer, M., “Good Faith: A Semiotic Approach”, ERPL 2002, 279 ff.

¹²⁰ Ibid. supra.

¹²¹ Hesselink, M., in Towards a European Civil Code, p. 295.

¹²² Ibid. supra.

“...a contract governing what is intended to be a long-term relationship requiring extensive cooperation between the parties continuing over many years. In such a case the parties may need to show flexibility and a willingness to adapt their behaviour if their joint venture is to succeed...We can define a ‘relational contract’ as one between parties whose relationship involves expectations of cooperation and loyalty...”¹²³

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¹²³ Leggatt, Jus. “Contractual Duties of Good Faith”, Lecture to the Commercial Bar Association, 18 Oct. 2016.

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