

Good Faith in English Contract Law: Of Triggers and Concentric Circles

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ABSTRACT

Good faith is regarded as a controversial topic under discussion in modern English contract law. Especially with the increasing significance of transnational law the impact of good faith on English law is likely to increase in the future. Though there is no general concept of good faith, according to the circumstances of each case the judges are eager to develop a variety of good faith related principles. Comparison with the German law may also be helpful in making an extended analysis of good faith and creating a more solid and general rule. Also the basic moral notion of honesty may be used for the understanding of good faith. But it should not be forgotten that recognition of a general principle may lead to some uncertainty in the contract law, so the concept of good faith should be solid enough to be certain, but should be flexible enough to be fair.

ÖZET

İyiniyet kavramı, modern İngiliz sözleşme hukukun halen çok tartışmalı olan kavramlarından biridir. Özellikle ulusal sınırları aşan hukukun önemini arttırmasıyla birlikte, İngiliz hukukunda da gelecek yıllarda iyiniyet kavramının etkilerinin artacağı muhtemel gözükmektedir. Her ne kadar henüz bir genel iyiniyet kavramı oluşturulamadıysa da, her somut olayın özelliklerine göre hakimler, iyiniyet ile ilgili çeşitli ilkeler geliştirme eğilimindedirler. İyiniyet kavramının daha geniş bir incelemesinin yapılması ve daha kesin genel bir ilkenin oluşturulması için Alman hukukundan karşılaştırma yoluyla

yararlanmak da faydalı olacaktır. Ayrıca temel bir ahlaki kavram olan dürüstlük kavramı da iyiniyetin anlaşılması için kullanılabilir. Ancak bu alanda genel bir ilkenin kabulünün sözleşme hukukunda kısmen belirsizliğe yol açabileceği unutulmamalıdır, bu nedenle iyiniyet kavramının belirli olmaya yetecek kadar kesin, buna karşılık adil olacak kadar da esnek bir nitelik taşıması gerekir.

KEY WORDS

English Contract Law, Good Faith, Honesty, Freedom of Contract

ANAHTAR KELİMELER

İngiliz Sözleşme Hukuku, İyiniyet, Dürüstlük Kuralı, Sözleşme Özgürlüğü

1. Introduction

Hugh Mills¹ once observed that “nothing unites the English like war. Nothing divides them like Picasso”. In the context of contract law, it could be said that ‘nothing unites English lawyers like the belief in the unique nature of the common law. Nothing divides them like the issue of good faith’.

Good faith is one of the most controversial topics under discussion in modern English contract law. The debate is not a new one (one of the leading papers was written as early as 1956²), but it is only in recent years that it has attracted widespread attention. This new-found prominence (some would perhaps say: notoriety) is clearly evidenced by the amount of academic writing it has generated³, and, judging from the growing number of cases that contain

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¹ British Screenwriter 1913 – 1971.

² R. Powell, “Good Faith in Contracts” (1956) 9 C.L.P. 16.

³ See e.g. J.F. O’Connor, “Good Faith in English Law” (1990, Dartmouth); J. Steyn, “The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?” (1991) Denning L.J. 131; J. Adams, “The Economics of Good Faith in Contract” (1994-95) 8 J.C.L. 126; R. Brownsword, “Two Concepts of Good Faith” (1994) 7 J.C.L. 197; J. Beatson & D. Friedman (eds.), “Good Faith and Fault in Contract Law” (1995, Clarendon); R. Harrison, “Good Faith in Sales” (1997, Sweet & Maxwell); G. Teubner, “Legal Irritants: Good Faith in British Law or how Unifying Law Ends Up in New Divergences” (1998) 61 M.L.R. 11; R. Brownsword, N. Hird & G. Howells, “Good Faith in Contract – Concept and Context” (1999, Ashgate); A.D.M. Forte (ed.), “Good Faith in Contract and Property” (1999, Hart); J. Stapleton, “Good Faith in

express references to this concept⁴, good faith appears also to have worked its way into the judicial consciousness.

The reasons for the current levels of interest would seem to be both realistic and idealistic in nature. From a purely pragmatic perspective it can be argued that as a result of the influence of international and EC law, English law will have to address the issue of good faith sooner or later⁵, so it might as well get to grips with it now. This argument is particularly pertinent in light of the Unfair Terms in Consumer Contracts Directive⁶ and the fact that the test of good faith contained therein has been retained without change or clarification in the Unfair Terms in Consumer Contracts Regulations 1999⁷. The increasing significance of transnational law, be it in the guise of the Convention on Contracts for the International Sale of Goods or the Principles of European Contract Law⁸, means that the impact of good faith is likely to increase rather than decrease in the foreseeable future, and English law must seriously question whether it can afford to ignore this development⁹. On a more ideological level, good faith can be regarded as a tool for the substantive improvement of contract law. This view focuses on what are generally perceived to be the more “communitarian values”¹⁰ embodied in this principle, ranging from a consumer-welfarist

Private Law” (1999) C.L.P. 1; R. Zimmermann & S. Whittaker, “Good Faith in European Contract Law” (2000, Cambridge University Press);

⁴ E.g. *Imperial Group Pension Trust Ltd. v. Imperial Tobacco Ltd.* [1991] 1 W.L.R. 589, 597 (per Sir Nicholas Browne-Wilkinson V.-C.); *Abu Dhabi National Tanker Co. v. Product Star Shipping Ltd. (The “Product Star”) (No. 2)* [1993] 1 Lloyd’s Rep. 397, 404 (per Leggatt); *Philips Electronique Grand Public S.A. v. British Sky Broadcasting Ltd.* [1995] E.M.L.R. 472, 484 (per Bingham M.R.); *Balfour Beatty Civil Engineering Ltd. v. Docklands Light Railway Ltd.* [1996] 78 B.L.R. 42, 58 (per Bingham M.R.); *Gan Insurance Co. Ltd. v. Tai Ping Insurance Co. Ltd.* [2001] EWCA Civ 1047, [2001] 2 All E.R. (Comm) 299, [67] (per Mance L.J.); *Nash & Staunton v. Paragon Finance plc.* [2001] EWCA Civ 1466, [2002] 1 W.L.R. 685, [11] (per Dyson L.J.).

⁵ Cp. E. McKendrick, “Good Faith: A Matter of Principle?”, in Forte op. cit., p. 39, 59; R. Zimmermann & S. Whittaker op cit., p. 13.

⁶ Council Directive 93/13 EEC (O.J. No. L95, 21.4.93, p. 29).

⁷ S.I. 1999/2083.

⁸ See generally O. Lando, “Principles of European Contract Law: An Alternative to or a Precursor of European Legislation? (1992) 40 A.J.Comp.L. 573; O. Lando & H. Beale (eds.), “The Principles of European Contract Law” (2000/3, Kluwer Law International). On good faith in a European Civil Code, see H. Kötz, “Towards a European Civil Code: The Duty of Good Faith”, in P. Cane & J. Stapleton (eds.), “The Law of Obligations – Essays in Celebration of John Fleming” (1998, Clarendon), p. 243.

⁹ J. Adams & R. Brownsword, “Understanding Contract Law” (4th ed. 2004, Thomson Sweet & Maxwell), p. 113.

¹⁰ Teubner op. cit., p. 11.

interpretation of the law¹¹ to the open protectionism of the Unfair Terms in Consumer Contracts Regulations 1999.

One of the most notable features of the current debate is the absence of any real consensus as to the scope and meaning of good faith. Interpretations range from “laying one’s card’s face upward on the table”¹² to a concept that is less exacting than reasonableness¹³ to “a critical morality of co-operation”¹⁴. Some have claimed that it is impossible to define¹⁵, while others suggest definitions that raise as many questions as they answer¹⁶ or abandon the search for a positive definition in favour of an excluder analysis¹⁷. It is submitted that most attempts at definition fail because they focus on the applications of good faith, rather than the core concept. The applications of good faith must always depend on the circumstances of each case; their scope can be narrowed through the identification of parameters, but it is necessarily impossible to capture their totality in a short, snappy sentence. In contrast, the idea of good faith itself, its central purpose and ideology, can be defined and, as will be seen below, it can be visualised.

2. Pre-Contractual Good Faith Distinguished

In order to achieve this, it is vital to start the conceptual analysis at the right point. A significant number of people seem to equate the notion of good faith primarily with a duty to negotiate in good faith¹⁸. Thus Lord Ackner’s famous dictum in *Walford v. Miles*¹⁹, that “[a] duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a

¹¹ Cf. Adams & Brownsword op.cit. p. 110 *et seq.*

¹² *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.* [1989] Q.B. 433, 439 (per Bingham L.J.).

¹³ Stapleton op. cit. p. 8.

¹⁴ R. Brownsword, “Contract Law: Themes for the Twenty-First Century” (2000, Butterworths), p. 116.

¹⁵ This is true even in Germany. See E. Wolf, “Das Arbeitsverhältnis” (1070, N.G. Elwert), pp. 22, 26.

¹⁶ For example O’Connor op.cit, p. 11: “[A] fundamental principle derived from the rule *pacta sunt servanda* and other legal rules distinctively and directly related to honesty, fairness and reasonableness, which supplements or supersedes normally applicable rules when this is necessary to ensure that the standards of honesty, fairness and reasonableness which prevail in the community also prevail in English law.”

¹⁷ R. Summers, “‘Good Faith’ in General Contract Law and the Sales Provisions of the Uniform Commercial Code”, 54 Va. L. Rev. 195 (1968).

¹⁸ See e.g. O’Connor op. cit., p. 35 *et seq.* This habit is perhaps influenced by the well-known and broadly applied German doctrine of *culpa in contrahendo* (although it should be noted that this has now been given a separate legal basis in the new Law of Obligations). See generally MünchKomm/Roth Vor §275 no. 48 *et seq.*; Staudinger/Schmidt §242 no. 1454.

¹⁹ [1992] 1 All E.R. 453.

negotiating party"²⁰ is regularly used as an argument against good faith *per se*, even though he was clearly referring to the pre-contractual context only. It may well be that a general principle of good faith would eventually be applied, not only to the performance and enforcement of agreements, but also to their formation; perhaps there is even a case to be made for the recognition of duties that continue after the contract has come to an end. However, the identification of good faith in relation to performance does not automatically include its extension to pre-contractual negotiations²¹. As will be seen below, good faith is bound into the framework created by the parties, and the agreement plays an important part in the application of good faith to the particular context. Contract negotiations do not, *prima facie*, produce the same level of connectivity²², and as a result the conceptual analysis of good faith advocated here cannot simply be extended, especially not at this stage of its development. It is important that the meaning of good faith is established in a defined context, namely the performance of contracts, before its application in other areas is investigated. To progress in the reverse order, starting with pre-contractual good faith and using this to reject all aspects of this principle, is to misunderstand both the relationship between these two concepts and the differences between the formation and performance of contracts. It must be understood that pre-contractual good faith is a potential application of the general theory, not the other way round. To base the analysis of the principle on a specific context, the relevance of which has not yet been established, would introduce irrelevant considerations into the interpretation of good faith and would most likely distort its meaning. It is therefore important to retain a clear analytical differentiation between contract performance and contract formation; pre-contractual good faith, a notion which is in itself lacking in doctrinal clarity, cannot serve as a basis for either the interpretation or the rejection of a general concept of good faith. It is for this reason that the negotiating stage has been excluded from the ambit of this paper; all following arguments proceed on the basis that a valid agreement has been concluded between the parties.

A similar risk of distortion of the good faith debate is presented by unquestioning references to the principle of utmost good faith, as it exists, for example, in insurance law. The relationship between these two concepts is a matter for separate investigation; all that needs to be said here is that utmost good faith has developed into such a distinct principle that its integration into

²⁰ *Ibid.*, p. 461.

²¹ J. Adams & R. Brownsword, "Key Issues in Contract" (1995, Butterworths), p. 201.

²² But query whether factors such as the existence of an ongoing relationship or an extended course of dealing between the parties could create a sufficient level of cohesion.

the broader debate must wait until the meaning of good faith has been properly understood.

3. Implied Terms as Functional Equivalents to *Treu und Glauben*

The most common underlying assumption seems to be that good faith is a purely moralistic standard which cannot be reconciled with the way in which especially commercial parties operate. In order to show that this is not so, it is necessary to answer two preliminary questions: First, is the notion of good faith really completely alien to English law? And second, is it possible and necessary to formulate a general theory?

The answer to the first question is most easily supplied through a comparative analysis with an existing concept of good faith, to determine whether any similarities can be found in the way in which different legal systems address particular problems. An obvious choice of comparator in this search for functional equivalents²³ is §242 of the German civil code, the *Bürgerliches Gesetzbuch*. Its concept of *Treu und Glauben* is generally regarded as one of the widest incarnations of good faith²⁴ (in application if not in wording), and over the past 100 years judicial and academic writings have combined to develop a formidable jurisprudence on its application and conceptual analysis.

If one were to do no more than glance at the way in which English and German law deal with particular situations, one might be forgiven for concluding that the English equivalent to the German concept of *Treu und Glauben* is equity. After all, some of the best-known applications of §242 have direct equitable counterparts: the doctrine of *venire contra factum proprium*, for example, is the German version of estoppel, while *Verwirkung* provides for the unenforceability of rights due to unreasonable delay, as does the doctrine of laches. However, this overlap is clearly not enough to render either concept the mirror image of the other. At a conceptual level, *Treu und Glauben*, despite its broad application that has exceeded the boundaries of contract law²⁵, remains a legal concept, while equity is a jurisdiction. In practical terms, too many differences remain in their scope, and many applications of §242 find their match not in equitable, but in statutory or common law rules. Of these, the most relevant here are implied terms.

²³ It should be noted that what matters is whether two concepts fulfil the same function; this does not mean that the detailed rules have to be identical.

²⁴ Zimmermann & Whittaker op cit., p. 59.

²⁵ Palandt/Heinrichs §242 no. 16/17; Jauernig/Vollkommer §242 no. 10.

In his doctoral thesis "*Implied Terms und Treu und Glauben*"²⁶, Wolfgang Grobecker undertakes a detailed comparative analysis of the implication of terms in English law and corresponding applications of §242²⁷. His conclusion is that "the method of implication of terms, as a traditional legal principle of the common law, leads to results which, in civil law, are achieved through the recognition of the concept of *Treu und Glauben* in contractual relations. English law therefore proves itself to be the counterpart to continental legal conception, in an area of contract law which was generally regarded as characteristic for the qualitative difference between common law and civil law"²⁸.

Grobecker's work clearly demonstrates that implied terms are a key functional equivalent to §242. Significantly, this applies not only to areas like consumer and employment law, where both courts and Parliament have traditionally been more interventionist, but also to purely commercial agreements. A good example is the duty to co-operate, developed in cases like *Mackay v. Dick*²⁹, which finds its counterpart in the German *Mitwirkungspflicht*³⁰. Furthermore, this is not a recent phenomenon; 19th century cases like *Leduc & Co. v. Ward*³¹ and *Glynn v. Margetson & Co.*³² show that the courts have long been prepared to interfere in apparently clearly worded business contracts, restricting broadly-phrased deviation clauses to prevent their exercise being inconsistent with the purpose of the contract³³.

These parallels confirm that the traditional view of German and English law representing opposite ends of a spectrum (one recognising a very broad concept of good faith and the other none at all) cannot be supported – good faith is clearly not entirely alien to the common law. This does not mean, of course, that §242 can simply be introduced into English law as if this were nothing

²⁶ W. Grobecker, "Implied Terms und Treu und Glauben", *Schriften zum Bürgerlichen Recht*, Band 227 (1999, Duncker & Humblot).

²⁷ For a comparative analysis which seeks to identify German equivalents to the English concept of implication of terms, see M. Schmidt-Kessel, "Implied Terms – Auf der Suche nach dem Funktionsäquivalent" (1997) 96 ZVglRWiss 101.

²⁸ Grobecker op. cit., p. 260.

²⁹ (1881) 6 App. Cas. 251. See also *Barque Quilpué Ltd. v. Brown* [1904] 2 K.B. 264; *Harrison v. Walker* [1919] 2 K.B. 453; *Kurt A. Becher GmbH & Co. K.G. v. Roplak Enterprises S.A. (The "World Navigator")* [1991] 2 Lloyd's Rep. 23; *Davy Offshore Ltd. v. Emerald Field Contracting Ltd.* (1991) 27 Const. L.R. 138; *Nissho Iwai Petroleum Co. Inc. v. Cargill International S.A.* [1993] 1 Lloyd's Rep. 80.

³⁰ Grobecker op. cit., p. 214. See generally Grobecker op. cit., p. 178 *et seq.*; Jauernig/Vollkommer §242 no. 23; MünchKomm/Roth §242 no. 214 *et seq.*

³¹ (1888) 20 Q.B.D. 475.

³² [1893] A.C. 351.

³³ *Ibid.*, p. 355.

more than a technicality³⁴. *Treu und Glauben* is an integral part of the BGB and its interpretation has necessarily been influenced, not only by the requirements of a codified system, but also by cultural factors and historical events. It is, however, perfectly possible for English law to develop its own understanding of good faith. Such a 'home-grown' concept would not encounter any of the problems so graphically described by Teubner, because it would not be an alien intruder at all. Good faith is already part of "law's binding arrangements"³⁵ and while its express recognition may well occasion some changes, these would occur as part of the natural progression and development of the law. A comparative analysis of *Treu und Glauben* plays an important part in the extended analysis of good faith and can serve to improve its coherence and transparency, but this in no way involves the direct transplantation of rules.

In order to move from a functional equivalence between English and German law to a coherent theory of good faith, it is necessary to show that the similarities identified are not confined to individual aspects, but that it is possible to identify a general theme in English law

4. Implied Terms and the Balancing of Interests

The debate about the correct basis for the implication of terms in law has occupied judges and academics for a considerable time³⁶. After the reinforcement of the concept of necessity by the House of Lords in *Liverpool City Council v. Irwin*³⁷ the courts have gradually moved away from this terminology, at least to the extent that it might have been intended to denote a strict test of absolute necessity³⁸ (akin to the meaning of that word in the context

³⁴ See Teubner op. cit.

³⁵ Teubner op. cit., p. 12. See Lücke op. cit., p. 182.

³⁶ E.g. *Liverpool City Council v. Irwin* [1977] A.C. 239, *In re Charge Card Services* [1989] Ch. 497, *London Borough of Merton v. Stanley Hugh Leach Ltd.* (1985) 32 Build. L.R. 51, *Scally v. Southern Health & Social Services Board* [1992] 1 A.C. 295, *Crossley v. Faithful & Gould Holdings Ltd.* [2004] EWCA Civ 293, [2004] 4 All E.R. 447. See A. Phang, "Implied Terms in English Law – Some Recent Developments" (1993) J.B.L. 242; G.J. Tolhurst and J.W. Carter, "The New Law on Implied Terms" (1996-97) 11 J.C.L. 76; E. Peden, "Policy Considerations Behind Implication of Terms in Law" (2001) 117 L.Q.R. 459.

³⁷ [1977] A.C. 239.

³⁸ Cf. Atiyah, *An Introduction to the Law of Contract* (5th ed. 1995, Oxford University Press), p. 207: "[I]t is evident that the formula that implications can only be made when necessary is not to be taken too literally. It is not necessary to have lifts in blocks of flats ten storeys high (indeed high-rise buildings existed long before lifts were invented), though it would no doubt be exceedingly inconvenient not to have them. So 'necessary' really seems to mean 'reasonably necessary', and that must mean, 'reasonably necessary having regard to the context and the price'. So in the end there does not seem to be much difference between what is necessary and what is reasonable." See also Phang op. cit., pp. 245 *et seq.*; G. Treitel, "The Law of Contract" (11th ed. 2003; Thomson Sweet & Maxwell), p. 208.

of the business efficacy test for implication of terms in fact)³⁹. The most recent in this line of cases is *Crossley v. Faithful and Gould Holdings Ltd.*⁴⁰. Even though the key statement by Dyson L.J. is phrased in somewhat hesitant language (perhaps because he did not wish openly to challenge the authority of the House of Lords), his is the clearest departure so far from the language used in *Liverpool City Council v. Irwin*, as he expressly suggests that “rather than focus on the elusive concept of necessity, it is better to recognise that, to some extent at least, the existence and scope of standardised implied terms raise questions of reasonableness, fairness and the balancing of competing policy considerations”⁴¹.

Clearly this statement leaves questions unanswered (for example as to the exact relationship between the three elements), but it nevertheless represents an important recognition of the true nature of implied terms. It is submitted that the implication of terms in law is in fact always a balancing exercise – an attempt by the courts to reconcile conflicting interests. The following analysis will also show that this balancing exercise takes place at three interlinked levels.

The most immediate tension in a contract arises between the parties to the agreement, usually in relation to the applicability or interpretation of particular clauses. Many people assume that in this situation the courts could simply use any general concept of good faith to decide (on no more certain basis than their own personal preference) which party should win, thereby creating an unacceptable level of uncertainty. As a result, they reject the idea of good faith altogether.

However, these critics fail to appreciate two things. First, the question is always how the parties themselves intended a contract to be enforced; and even taking into account the usual caveats about the courts’ ability to determine the parties’ actual intentions, this is still a different standard than the judge’s own point of view⁴². What it requires is a purposive interpretation of contracts, focusing on the spirit rather than the letter of the agreement. This is something

³⁹ *In re Charge Card Services Ltd.* [1989] Ch. 497, 513 (per Sir Nicholas Brown-Wilkinson); *London Borough of Merton v. Stanley Hugh Leach Ltd.* (1985) 32 Build. L.R. 51, 76 (per Vinelott J.).

⁴⁰ [2004] EWCA Civ 293.

⁴¹ *Ibid.* [36].

⁴² The fact that traditional references to the presumed intention of the parties have now been acknowledged to be legal fictions (see *Watts v. Aldington* [1999] L. & T.R. 578, discussed in A. Phang, “Implied Terms, Business Efficacy and the Officious Bystander – a Modern History” (1998) J.B.L. 1, p. 27) does not change the fact that the intentions of the parties *are* relevant; it merely acknowledges that they are not the only thing that is.

the English courts have long engaged in⁴³ and, once again, illustrates the close link between this aspect of the common law and German law⁴⁴ - not least because several of the cases contain express references to good faith⁴⁵.

Secondly, the interests of the parties are only the starting point of the balancing exercise. Whenever they are considering the implication of a term into a contract the courts must – and do – look at two other crucial elements: the interests of the market, and the interests of society as a whole.

Few people will be surprised by the assertion that the interests of society, more commonly referred to as policy considerations, are relevant in this context. Good faith is all too often seen as nothing but a window for the unprincipled incursion of vague ideas of policy, and even in the more traditional environment of implied terms (without any reference to good faith), the significance of such issues is increasingly recognised⁴⁶. Less well explored, and yet central to a proper understanding of good faith, is the relevance of the market within which the parties are operating. Of course the courts have always implied terms into individual contracts on the basis of market practice (if it was sufficiently certain to be classified as a custom), but its influence goes a lot deeper: the interests of the market play a key role in determining the standard and even the meaning of good faith.

When deciding whether to imply a term into a contract the courts regularly consider the potential impact of their decision on the relevant market, essentially asking whether the suggested term is necessary to ensure the viability of commercial activities⁴⁷. This is often used as an argument against

⁴³ See the commentary to *Balfour Beatty Civil Engineering Ltd. v. Docklands Light Railway Ltd.* [1996] 78 B.L.R. 42, 45: “[T]he effect of the Court of Appeal’s decision in this case is that the employer’s judgment was rendered incapable of challenge upon matters which would vitally affect the interests of the contractor and of the employer and upon which, in effect, the employer was made judge in his own cause. This has not been a situation which the courts have commonly been persuaded to consider contracting parties readily intend”. See also *Mackay v. Dick* (1881) 6 App. Cas. 251; *Glynn v. Margetson & Co.* [1893] A.C. 351; *Union Eagle Ltd. v. Golden Achievement Ltd.* [1997] 2 All E.R. 215; *Gan Insurance Co. Ltd. v. Tai Ping Insurance Co. Ltd.* [2001] 2 All E.R. (Comm) 299.

⁴⁴ Cf. §157 BGB and the purposive interpretation of contracts in German law: Grobecker op. cit., p.156. See generally Jauernig/Vollkommer §242 no. 17.

⁴⁵ E.g. *Gan Insurance Co. Ltd. v. Tai Ping Insurance Co. Ltd.* [2001] 2 All E.R. (Comm) 299. See also *Abu Dhabi National Tanker Co. v. Product Star Shipping Ltd. (The “Product Star”)* (No. 2) [1993] 1 Lloyd’s Rep. 397, p. 404.

⁴⁶ *Scally v. Southern Health & Social Services Board* [1992] 1 A.C. 295; *Crossley v. Faithful & Gould Holdings Ltd.* [2004] 4 All E.R. 447.

⁴⁷ *Leduc & Co. v. Ward* (1888) 20 Q.B.D. 475; *Glynn v. Margetson & Co.* [1893] A.C. 351; *Gan Insurance Co. Ltd. v. Tai Ping Insurance Co. Ltd.* [2001] 2 All E.R. (Comm) 299. It is worth noting that market considerations have also been regarded as relevant in the context of

the recognition of good faith, particular emphasis being placed on the well-documented need for certainty in commercial transactions. Once it is understood, however, that good faith is a tool for the balancing of conflicting interests (and that these interests are necessarily influenced by the nature and circumstances of the specific transaction) it becomes clear that such considerations do not run counter to the existence of a general concept of good faith at all – in fact, they are integral to it.

A useful illustration is provided by *Union Eagle v. Golden Achievement Ltd.*⁴⁸ A contract for the sale of a flat in Hong Kong provided for completion by five p.m. on a specified day. The buyer in fact tendered the purchase price and relevant documents at 5.10 p.m. on the day in question, at which point the seller refused to accept them. In answer to the purchaser's claim for specific performance, the Privy Council held that there was no ground for intervention.

At first glance, this may appear an unduly harsh decision, and one that would be likely to attract the assertion that the vendor had obviously behaved in bad faith – after all, it is difficult to see how a delay of only ten minutes could have caused him any real harm, and yet the buyer forfeited a substantial deposit because of it.⁴⁹ The immediate counter-argument to this line of reasoning focuses on the need for absolute certainty as proof of the undesirability of good faith-based arguments in a commercial context, and this, indeed is the line taken by the Privy Council, and Lord Hoffmann in particular: “The fact is that the purchaser was late. Any suggestion that relief can be obtained on the ground that he was only slightly late is bound to lead to arguments over how late is too late, which can be decided only by litigation. For five years⁵⁰ the vendor has not known whether he is entitled to resell the flat or not. It has been sterilised by a caution pending a final decision in this case. In his dissenting judgment, Godfrey JA said that the case ‘cries out for the intervention of equity’. Their Lordships think that, on the contrary, it shows the need for a firm restatement of the principle that in cases of rescission of an ordinary contract of sale of land for failure to comply with an essential condition as to time, equity will not intervene.”⁵¹

consumer transactions, for example in *Nash & Staunton v. Paragon Finance plc* [2002] 1 W.L.R. 685. Note also the reference to *Verkehrssitte* (common usage) in §242 BGB.

⁴⁸ [1997] 2 All E.R. 215.

⁴⁹ For an argument that the Privy Council should have allowed the separate remedy of equitable relief against forfeiture of the deposit, see J. Stevens, “Having Your Cake and Eating It? *Union Eagle Ltd. v. Golden Achievement Ltd.*” (1998) 61 M.L.R. 255.

⁵⁰ The five years mentioned by Lord Hoffman refer to the time the litigation had taken by the time the matter came before the Privy Council.

⁵¹ [1997] 2 All E.R. 215, 222.

In fact, this case is neither incompatible with a general concept of good faith, nor is it necessary to treat it as some sort of exception in order to maintain the required level of certainty. The good faith argument outlined above may be what most people would think of when asked to assess the potential impact of good faith on *Union Eagle*, but it is based on a wrong idea about the nature of good faith, and thus leads to a wrong conclusion. Once good faith is correctly understood as closely linked to the individual contract and the parties' intention, it becomes clear that in commercial contracts it not only allows, but actually requires, the strict enforcement of deadlines. In this case both parties expected and intended the contract to be completed by a specified time on a specified day (the seller had even reminded the buyer of the need to deliver the documents and purchase price on time). In addition, this was a commercial contract, *i.e.* a market in which stipulations as to time are regarded as conditions, and, there were no policy considerations that would override other factors. At all levels of the analysis, therefore, good faith required this deadline to be strictly complied with.

There is a German decision of the *Reichsgericht*⁵² which seems to contradict what has just been said; substituting an arbitrary standard of *Treu und Glauben* for the certainty required in commercial transactions. The case concerned a contract for the charter of the vessel 'Hansa', which granted the charterer the right to rescind the contract, should the ship not be available for loading by 12 p.m. on 30 December 1925. In fact she was not ready until 12.30 p.m. on the day in question, and on 2 January 1926 the charterers purported to rescind the contract. The *Reichsgericht* held that this amounted to a breach of §242. This case seems to reach exactly the opposite conclusion to *Union Eagle*, on the basis of a very similar set of facts. A closer analysis of the reasoning of the German court reveals, however, that the two decisions are not as diametrically opposed as they appear.

After having reiterated the general point that §242 applies to the entire law of obligations, including clauses such as the one under consideration, the *Reichsgericht* went on to stress the need of "having due regard to the importance that has been attached, according to the express intention of the parties, to compliance with stipulations as to time of performance. It is only in very exceptional cases that exceeding the agreed period will not trigger the right to rescind"⁵³. Such exceptional circumstances will be present if the delay is not

⁵² RGZ 117, 354.

⁵³ *Ibid.*, p. 356.

only insignificant in itself, but also appears negligible when the other party's interests in punctual performance are taken into account⁵⁴.

In the *Hansa* case, the *Reichsgericht* concluded that the purpose of the rescission clause was to ensure that the ship arrived sufficiently early to allow the charterer to process his cargo as a December load, something which was not affected by the short delay⁵⁵. It was only in the light of this conclusion that the attempt to rescind the contract amounted to a breach of *Treu und Glauben*. If this case had arisen before an English court, it would most likely have been decided on the basis that, on proper construction of the agreement, the time of readiness to load was not of the essence⁵⁶. It is in this respect that the *Hansa* case differs significantly from *Union Eagle*. The two decisions do not represent one correct and one wrong application of good faith; they merely represent two situations in which the spirit of the agreement⁵⁷ differed, so that in one case strict enforcement of the deadline did amount to a breach, while in the other it did not.

That said, it must be acknowledged that the German case does stretch the application of *Treu und Glauben* in a commercial context. It is very noticeable that, although the decision is referenced in commentaries as an example of the application of *Treu und Glauben*⁵⁸, it has been cited only infrequently in subsequent cases⁵⁹. Generally it can be said that German courts are as aware of the need for certainty in commercial transactions as their English counterparts⁶⁰; and this includes the usually strict enforcement of deadlines⁶¹.

⁵⁴ *Ibid.*, pp. 356-57.

⁵⁵ *Ibid.*, p. 356. In support of this conclusion the *Reichsgericht* noted that the charterers had not attempted to rescind the contract until several days later.

⁵⁶ Cf. *Universal Cargo Carriers Corporation v. Citati* [1957] 2 Q.B. 401.

⁵⁷ RGZ 117, 354, 357: "cases...in which the delay is not only minimal in itself, but also appears so insignificant when the interest of the creditor in compliance with the deadline is taken into account, that, while its observance would comply with *the letter of the contract*, it would not be compatible with performance according to fair discretion [*billiges Ermessen*] and the requirements of *Treu und Glauben*" (emphasis added).

⁵⁸ E.g. MünchKomm/Roth §242 no. 545.

⁵⁹ Note also the fact that RGZ 117, 354 is the only case cited in H. Wüstendörfer, "Neuzeiliches Seehandelsrecht" (2nd ed. 1950, J.C.B. Mohr), p. 248, and H. Prüßmann & D. Rabe, "Seehandelsrecht" (3rd ed. 1992, C.H. Beck) §567, note 2.a).

⁶⁰ See, for example, the following statement by the *Reichsgericht* RGZ 117, 354: "The owner's stipulations as to the time of the ship's readiness to load are important to the charterer. They enable him to make arrangements concerning the goods to be loaded so that, as far as is possible, they are ready at the loading point on time, neither too early nor too late, and thereby to avoid unnecessary expenditure on storage charges or demurrage. They also protect him from the arbitrariness of the owner in relation to the ship's readiness. These are, therefore, stipulations

This does not mean, of course, that there can never be a breach of good faith in a commercial setting. An illustration can be found in *Nissho Iwai Petroleum Co. Inc. v. Cargill International S.A.*⁶². An agreement for the sale of crude oil provided for the making of certain declarations over the telephone, which had the effect of converting a so-called undated contract into a dated one, for which there was a different market. There was a strict deadline of five p.m. for the making of such nominations. On the day in question, the seller attempted to make a declaration at the last minute, but the buyer delayed answering the telephone until after five o'clock (it was accepted that the seller would have had sufficient time to complete the nomination, had the buyer answered the telephone without delay). Hobhouse J. held that it was "an inevitable inference from cl. 3(a) [which provided for the making of nominations by telephone] that, the buyer having made available the facilities and personnel to receive declarations promptly, they should then be used. Similarly it is an implied term of a contract that one party shall not obstruct or prevent the other from performing the contract. ... To delay in answering the telephone so as to prevent a seller from giving a valid nomination under the contract is a breach of an implied term in the contract"⁶³. Both parties had intended this system of nominations to be used, and neither was allowed to deliberately obstruct performance.

Crucially, in both cases the courts considered the interests of the market within which the parties were operating. In *Union Eagle* Lord Hoffmann strongly emphasised the need for certainty in the relevant commercial setting⁶⁴, and in *Nissho Iwai* the buyer was held to be in breach, not because his conduct had been morally wrong, but because the market could not operate if everybody were to behave as he had⁶⁵. The standard applied in these cases is that created by the contract and the market – it is a contextual, practical approach rather than an abstract moralistic one⁶⁶. This also means that the duties imposed on parties are limited to what is required in a particular situation. The question is always whether the contract could be performed as intended by the parties without a

which are of significant importance to the charterer. ... English law has long adopted the same point of view."

⁶¹ MünchKomm/Roth §242 no. 545.

⁶² [1993] 1 Lloyd's Rep. 80.

⁶³ *Ibid.*, p. 84.

⁶⁴ [1997] 2 All E.R. 215, 222.

⁶⁵ [1993] 1 Lloyd's Rep. 80, 83 (per Hobhouse J.): "Since the making of nominations is by telephone and requires the active co-operation of the buyer to whom the nomination is to be passed on, it is a tribute to the good faith and sense of fair play of the participants in the market that the system can work at all."

⁶⁶ J. Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 L.Q.R. 433, 438.

certain degree of mutual co-operation, not whether the parties have done absolutely everything that could be done to aid the other. Good faith is not synonymous with altruism; parties are not expected to neglect their own interests in favour of those of the other side, they are only prevented from using the strict letter of the agreement to subvert its original purpose. Thus, in *Nissho Iwai*, the buyer was not allowed to undermine the method of communication that had been agreed, but he was not, for example, obliged to have more than one person available to take nominations⁶⁷.

5. An Overarching Concept of Good Faith?

Once it is accepted that English courts do recognise individual applications of good faith, the question arises as to whether it is necessary and possible to develop a general, overarching concept. Even people who do not reject the notion of good faith *per se* often doubt the usefulness of such a wider theory, preferring instead the current approach of developing individual solutions for individual problems. However, it is submitted that there are several arguments in favour of a general principle.

First, placing the individual applications in the context of an overarching principle will inform their future development and ensure that they do not drift off into something they were never intended to be. A good illustration of this risk is provided by the implied term of trust and confidence in employment law⁶⁸. The recognition of this duty, which is imposed on employers and covers a wide range of matters, such as the making of unsubstantiated allegations of theft against employees⁶⁹ and the running of a corrupt business⁷⁰, has led some academics to argue that employment should be reclassified as a fiduciary relationship⁷¹. Leaving aside the danger that such a move could ultimately weaken rather than strengthen the position of employees, this claim raises serious conceptual issues. To some extent at least it appears to be the result of a failure clearly to distinguish between the implied term of trust and confidence and the fiduciary relationship of the same name. Despite the terminological overlap, it is evident that the two are conceptually different, as was highlighted by Elias J. in *Nottingham University v. Fishel*⁷²: “[C]are must be taken not automatically to equate the duties of good faith and loyalty, or trust and

⁶⁷ [1993] 1 Lloyd's Rep. 80, 85.

⁶⁸ See generally D. Brodie, “The Heart of the Matter: Mutual Trust and Confidence” (1996) 25 I.L.J. 121.

⁶⁹ *Fyfe & McGrouther v. Byrne* [1977] I.R.L.R. 29.

⁷⁰ *Malik v. B.C.C.I.* [1998] A.C. 20.

⁷¹ L. Clarke, “Mutual Trust and Confidence, Fiduciary Relationships and the Duty of Disclosure” (1999) 28 I.L.J. 348.

⁷² *Nottingham University v. Fishel* [2000] I.R.L.R. 471, [96] (emphasis added).

confidence, with fiduciary obligations. Very often in such cases the court has simply been concerned with the question whether the employee's conduct has been such as to justify summary dismissal, and there has been no need to decide whether the duties infringed, properly analysed, are contractual or fiduciary obligations. As a consequence, the two are sometimes *wrongly treated as identical*.”

Identifying the implied term of trust and confidence as just one application of a general concept of good faith will help maintain this vital differentiation. While it is certainly possible that a broadening of its interpretation could eventually bring good faith closer to fiduciary duties, this has not happened yet, and until it does the implied term of trust and confidence must be seen in its proper context of good faith – a tool for the balancing of interests, not for the reclassification of relationships.

Secondly, an overarching concept, by its very nature, provides the potential for growth that is needed in areas where English law does not (or does not yet) provide a solution. There are numerous cases where judges clearly wanted to achieve a particular result (not least for policy reasons), but felt unable to do so because the law did not provide them with sufficiently flexible tools⁷³.

In some cases, judges managed to get around this problem by distorting existing principles, as in *Johnstone v. Bloomsbury Area Health Authority*⁷⁴. This case concerned the question whether the employer's express contractual right to demand a certain amount of overtime was limited by his implied duty to safeguard the employee's health.

The dissenting judgment of Leggatt L.J. presents the least problems, as he applied a strict contractual test to conclude that “as a matter of law reliance on an express term cannot involve breach of an implied term”.⁷⁵ The other two judges agreed that the employer was subject to an implied duty to safeguard the employee's health, but differed in their reasoning.

Stuart-Smith L.J. held that the health authority's power to demand overtime “had to be exercised in the light of the other contractual terms and in particular their duty to take care for his safety”⁷⁶, which appears to indicate that an implied term (at least one implied in law) can override an express clause of the contract. The judgment of Browne-Wilkinson V.-C., however, was much more limited. He was of the opinion that there was no actual conflict between the express and implied terms, and therefore saw “no technical legal reason why the Authority's

⁷³ E.g. *L'Estrange v. F. Graucob Ltd.* [1934] 2 K.B. 394. See Powell op. cit., pp. 26 *et seq.*

⁷⁴ [1991] I.R.L.R. 118.

⁷⁵ *Ibid.* [37].

⁷⁶ *Ibid.* [20].

discretion to call for overtime should not be exercised in conformity with the normal implied duty to take reasonable care not to injure their employee's health".⁷⁷ However, he made it clear that if the employee's obligation in respect of the 48 hours overtime he could be required to work had been absolute (rather than a discretion granted to the employer), the implied term could not have restricted the express provision of the contract⁷⁸.

Johnson thus leaves the crucial question about the relationship between express and implied terms unanswered. Both Stuart-Smith L.J. and Browne-Wilkinson V.-C. tried to achieve a fair outcome while at least outwardly maintaining traditional contract theory and its requirement that implied terms be regarded as default rules. The end result is a decision which must be right on the facts, but which cannot be supported in terms of legal analysis. The recognition of a general principle of good faith, centred around the balancing of the interests of the parties, the market and society as a whole, would provide the required flexibility to ensure an acceptable outcome based on sound and transparent reasoning⁷⁹.

6. The Visualisation of Good Faith

The final question that remains is: is it actually possible to develop a general concept of good faith that is sufficiently certain to be conceptually coherent, yet sufficiently flexible to be useful in different circumstances? The answer to this question lies in the concentric circle and the following visualisation.

At the centre of good faith lies the notion of honesty. This is the minimum requirement in contracts, and although it lies at the heart of good faith, it is usually enforced in other ways (for example through the rules on fraud and misrepresentation). From this centre, the various applications of good faith radiate outward in a series of concentric circles. Each circle signifies one standard of good faith, and the distance of each circle from the centre determines its scope. The further away from the centre the circle, the higher the standard of behaviour that will be expected from the parties. Commercial contracts, for example, will be located on a circle close to the centre, which means that the law will be relatively non-interventionist – it will require little more of the parties than actual honesty. Consumer contracts, in contrast, will be found further away from the centre, meaning that a seller dealing with a consumer will face more stringent restrictions on the way he can operate. Employment contracts will be located further out still, imposing even greater duties of good faith on both parties.

⁷⁷ *Ibid.* [46].

⁷⁸ *Ibid.* [44].

⁷⁹ Brownsword *op. cit.*, pp. 108 *et seq.*

The visualisation of good faith as concentric circles highlights the two fundamental features of this concept. The circles represent the fact that 'good faith' is not simply a one-dimensional concept that is either required in a contract or not; its meaning and application depend on the circumstances of the case in question. The fact that all the circles have a common centre emphasises that the varying applications are nevertheless all derivatives of the same core concept; thereby providing the conceptual coherence that English law is currently lacking.

Once this structure of good faith has been understood, the next question is how one can determine on which circle a particular contract belongs. This obviously depends on the nature of the contract, and an attempt to provide fixed rules would deprive the law of an important degree of flexibility. It is, however, possible to identify a number of 'triggers', which will operate to move particular types of contract outward.

These triggers are elements of policy which impact on particular situations and set the boundaries that determine freedom of contract. It is here that the elasticity of good faith comes into its own. The values of society are not static. As they continue to move away from 19th century liberalism, it is likely that an increasing number of contracting parties will be identified as in need of special protection. Rather than necessitating the development of new legal rules, these changes can be translated into the law via the concept of good faith. A new policy will be reflected in a new trigger, and sometimes even a new circle.

The following list of triggers is not exhaustive, especially in view of the fact that society may, in future, come to recognise other forms of behaviour as deserving of intervention. They are also not in strict order of importance or frequency of application, as they may overlap in any particular case. In some instances, only one trigger will be relevant, while in others several may combine to impose a particularly stringent duty of good faith.

In order to identify triggers, one can start by analysing those groups of people who already receive special protection from the law. The most obvious examples are consumers and employees, both of which have been the subject of increasing regulation. The policy factor behind this intervention addresses two related issues, namely imbalance of bargaining power and inequality of information. The two are linked to the extent that imbalance of bargaining power is often caused (or at least exacerbated) by inequality of information. (It should be noted at this point that while the imbalance of bargaining power clearly raises the issue of contract formation, and therefore pre-contractual GF, it remains equally relevant during the performance and enforcement of contracts, for example because the stronger party can dominate the interpretation of contractual clauses.)

A further factor which will automatically increase the burden of good faith is the presence of what can be called the “personal element”. This means that a contract affects not only the financial interests of at least one party, but his or her very personality. This will be the case to a lesser extent in any contract for services which have to be performed personally, but is of special relevance in relation to contracts of employment. The importance of employment for an employee extends far beyond the financial income it provides, and touches complex issues of social standing and self-fulfilment. In these cases it is especially important that the individual should be protected against bad faith behaviour.

The example of employment contracts is useful to demonstrate the fact that the triggers of imbalance of bargaining power, inequality of information and involvement of the person can operate collectively or separately, depending on the case. In many cases all three will apply to an individual employee, but the absence of one does not affect the validity of the remaining. Thus the element of personal involvement will operate to increase the duties of good faith beyond the minimum standard, even though the balance of bargaining power may occasionally be shifted in favour of an individual employee.

The three triggers described are linked by the fact that they are grounded in public policy. Individuals are protected against the abuse of superior bargaining power because this accords with the egalitarian values of society. Other triggers, however, are linked not so much to the public’s perception of right and wrong, but to considerations of efficiency. For example, the law has increasingly begun to recognise the special nature of long-term contracts. The existence of an ongoing relationship between the parties can also operate as a trigger to impose a greater duty of good faith on either side. The stimulus here is not so much the desire to do what is right in a moral sense, but the need to promote the efficiency of the market. Long-term contracts usually involve a significant amount of investment (on both sides) that cannot be recouped in the short term. It is therefore in the interest of overall efficiency that the law should promote the maintaining of such relationships, by requiring both parties to act in good faith.

In some cases the presence of one or more of these triggers will be presumed simply because of the nature of the relative position of the parties, for example because they are, respectively, commercial seller and consumer buyer. However, the operation of these triggers is not limited to such recognised instances, and the parties are free to adduce evidence of imbalances in any contract, including purely commercial agreements. This approach has the benefit of avoiding the to some extent artificial differentiation between commercial and consumer contracts, by focusing not on an *a priori* distinction

but on the question whether, on the facts, there existed between the parties a gradient of some sort which could potentially be exploited by the stronger party.

7. Conclusion

In conclusion it can be said that good faith is not a purely moralistic standard, but one that is much more closely tied to the parties' intentions and the interest of the market than most people assume. English law already applies a variety of good faith-related principles, but would benefit from the recognition of a general concept. This is best visualised as a set of circles, concentrically placed around the basic moral notion of honesty, which is the minimum standard of behaviour required by the law from all contracting parties. From this centre point, the different applications of good faith spread out in ever-widening circles. The further a circle is from the centre, the more extensive the duties that will be imposed on the parties. An individual contract's position on this diagram depends on the presence and absence of certain triggers. These are instances in which policy considerations (whether in support of society's moral judgment or other values, such as efficiency) limit the extent of the basic principle of freedom of contract, so as to justify judicial intervention in the performance and enforcement of an agreement.

Much work remains to be done. The picture of the concentric circles identifies different standards of good faith, but it does not answer the question of what will amount to a breach in an individual case. In addition, the analysis of triggers must be continued in order to investigate other potentially relevant factors. The recognition of a general concept of good faith is only the beginning, not the end of the exercise.

However, English courts are uniquely suited to the task. They are already accustomed to distilling general principles from a body of case law. Good faith introduces a new terminology and shifts the existing focus to matters which have not always been expressly recognised as significant, but the legal methodology remains the same, regardless of whether the determination runs to good faith or the classic notion of reasonableness. It is no coincidence that, in developing their law of *Treu und Glauben*, the German courts adopted a common law technique – building up a body of case law to clarify the individual applications of the overarching concept.

It cannot be denied that the recognition of a general principle will lead to some uncertainty in the law. Developing a jurisprudence of good faith will take time, and many questions – theoretical and practical – remain to be answered. However, as the number of decided cases grows, each individual aspect of good faith – application, breach, triggers – will crystallize into a body of law, solid enough to be certain, flexible enough to be fair.