

GOOD FAITH IN DOMESTIC SALES LAW¹ E. Iftime

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Abstract

Good faith is a true principle widely established by the positive law. But how does this principle operate? How is the connection made between an undetermined legal standard, such as good faith, and the practical operations by which contractual obligations are fulfilled? The essay will answer to these questions by providing a comprehensive analysis of how the concept of good faith operates in a variety of national law systems.

Keywords: good faith, sales law, contract law, Romanian law, national legal systems.

Introduction

Lord Mansfield was referring, in the 18th century, to good faith as a general principle applicable to all contracts². The uniform application of the concept of good faith must be based on the idea that good faith is not a moral obligation. It is true that good faith originates from honesty, which is nothing but a sum of virtues, but it can be presumptuous to claim that good faith is the same as morality. In this way, consistency would remain a goal, since morality is a social duty based on cultural norms. Good faith becomes a self-contained concept when it becomes a legal concept, entering the legal field.

Good faith in Romanian law

In most civil legislations, the postulate of good faith is established as a legal relative presumption, which can be overturned by any evidence, including simple presumptions. In this regard, the Romanian Civil Code provides in art. 14 that any natural or legal person shall exercise their rights and perform their civil obligations in good faith, in accordance with the public order and good morals, good faith being presumed until proven otherwise. There was no text in the Civil Code of 1864 that would establish the concept and the presumption of good faith.

The concept of exercising rights and obligations in good faith, in accordance with the public order and good morals represents an element of novelty brought by the Romanian Civil Code which is also consistent with the provisions of the Constitution (art. 57- the constitutional rights and freedoms shall be exercised in good faith, without violating the rights and freedoms of others).

In the Civil Code we can find different applications of the concept of good faith. Good faith is a fundamental principle of the civil law and art. 1170 singularizes this solution in terms of the contract, covering the contractual period in which negotiations are performed, the mechanism of concluding the contract as well as its performance. Thus, art. 1170 provides that the parties shall act in good faith both in the negotiation and conclusion of the contract, as well as during its performance. They cannot remove or limit this obligation. The general principle of

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² Pelly v Royal Exchange Assurance Co. [1757] Burr. 341, 347.

good faith becomes an important governing principle of the contract theory. During the performance of contracts, the imperative of good faith requires an obligation for initiative, cooperation or collaboration, in order to allow an efficient contract performance, and behaviours that affect these aspects are forbidden. However, the obligation of good faith does not require the protection of someone else's interests to the detriment of their own.

Art. 1272 of the Civil Code assimilates fairness with the law, fairness thus becoming an implicit clause in the contract. According to the article in question a lawfully concluded contract requires not only what is expressly stipulated but also all the consequences of the practices established between the parties, customs, law and fairness given to the contract, according to its type. The common contract clauses are understood, although they are not explicitly stipulated.

Regarding the meaning of the concept of good faith in the artificial real estate accession, art. 586 stipulates that the performer of the work is of good faith if it is based either on the content of the land register, in which, at the time of the work, was registered as owner of the property or is in the course of owning it, not subject to registration in the land register if, in both cases, the defect of title did not result from the land register and he did not know about it in any other way. However, the person building by default or by not complying with the licences and permits required by law cannot invoke good faith.

Applications of the concept of good faith are also found in tabular usucaption. According to art. 931 the rights of the person registered, without legitimate cause, in the land register, as the owner of a building or holder of another real property, cannot be challenged when the person registered in good faith owned the property for five years after the time of registration of the application, if its ownership was not vitiated. Good faith is enough at the time the registration of the application is performed and it enters into possession.

In the matter of representation, according to art. 1300 good or bad faith, knowledge or ignorance of certain circumstances is assessed in the presence of the representative. Moreover, the represented party of bad faith can never invoke the good faith of the representative.

Good faith is associated to loyalty in art. 2079, as, in reference to the agency agreement, the agent shall fulfil, personally or by his agents, the obligations arising from the empowerment given to him in good faith and loyalty.

There is no proper penalty when there is no good faith in the negotiation, conclusion or performance of the contract. The liability form shall be outlined in accordance with the characteristics of the legal situation by which good faith was violated: presence of deceit shall entail tort liability (art. 1349), whereas non-performance in bad faith of a contractual obligation may result in the termination of the contract (article 1549).

A special innovative element of the Romanian Civil Code is the provision contained in art. 1183. The parties have the freedom of initiation, performance and termination of negotiations and cannot be held responsible for their failure. The party who undertakes a negotiation is required to comply with the requirements of good faith. The parties cannot agree the limitation or exclusion of this obligation. It is contrary to the requirements of good faith the conduct of a party initiating or continuing negotiations with no intention of concluding the contract. The party who initiates, continues or terminates negotiations contrary to good faith is liable for the damage caused to the other party. To establish this damage the costs incurred in the negotiations, the waiver by either party of the other bids and any similar circumstances shall be taken into account.

From the perspective of art. 1183, which takes into account free negotiation, carried out in the absence of a contractual framework, the pre-contractual negotiations are grouped around two main principles, contractual freedom and good faith. Such a regulation regarding the negotiations stage could not be found in the Civil Code of 1864, inspired from both the Principles of European Contract Law and the UNIDROIT Principles.

Contractual freedom implies the ability to conduct even parallel discussions and negotiations to compare the various proposals and to choose the most advantageous one, including the ability to terminate the negotiations if the said person considers that they are not

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relevant to its own interests. This freedom can be achieved only if the parties are not held responsible for the failure of the negotiations or their termination according to their will, the only requirement being that of acting in good faith.

The text of art. 1183 is an application of the more comprehensive principle of good faith, which aims at the exercise of rights and performance of obligations (art. 14) and contractual relationships in general (art. 1170).

The principle of good faith is raised to the level of public order, as the parties cannot agree to limit or exclude it. Due to the imperative character of this principle, a party may invoke violation of good faith in negotiations as prevailing on the agreed terms. In many cases, the parties agree to enter into an agreement to govern their conduct during the negotiations. The principle of good faith may be invoked even when the other party bases its actions on a contractual framework agreed by the parties with respect to the negotiations performance and termination method. Limiting the contractual freedom in such a way creates uncertainty regarding the classification of an action as being compatible or not with good faith, which generates a certain legal uncertainty for the person who must act in good faith³.

The obligation to act in good faith implies the undertaking of a loyal behaviour between the parties; art. 1183 contains illustrative (but not exhaustive) behaviour contrary to this principle: the case in which a party initiates or continues negotiations with no intention of concluding the contract. To the extent that there is an intention to conclude the contract, but other aspects required by good faith regarding the initiation, continuation or terminations of negotiations are violated, the guilty party may be liable in tort for the caused damage⁴.

Good faith remains an open concept, which can be interpreted according to the case. Going forward, the provision contained in art. 1183 should be read in conjunction with both the provisions of the Principles of European Contract Law and the provisions of the UNIDROIT Principles so that a climate of legal certainty can be maintained and thus the principle of contractual freedom established by art. 1183 shall not remain without content.

In Romanian law, good faith is established as a principle for the performance of procedural rights. For this purpose, art. 12 of the Romanian Code of Civil Procedure provide that the procedural rights shall be exercised in good faith, according to the purpose for which they were recognized by law without violating the procedural rights of another party. The party exercising its procedural rights in an abusive manner or fails to fulfil in good faith the procedural obligations is liable for the material and moral damages caused.

The party who diverts the procedural right from the purpose for which it was recognized and exercises it in bad faith or violating the procedural rights of another party commits an abuse of procedural right.

To determine which is the content of good faith from the procedural point of view, we shall start from the definition of good faith in general, and hold those elements of it which are apparent in the exercise of procedural rights, while also keeping in mind the significant differences between the two concepts, on the one hand, in terms of substantive law, and on the other hand, in terms of the procedural law.

Taking into account that in terms of procedural rights good faith is presumed, if a person states bad faith in the exercise of procedural rights, or in order to paralyse its action or, in case of damage, in order to obtain damages, he/she must prove it.

Good faith has different aspects depending on each procedural right because the premises and penalties established by the legislator to sanction the lack of good faith are different.

As a subjective procedural attitude which the subject of the procedural right must have, good faith represents the inner and unmistakable conviction of the party that the exercise of the procedural right in the way it chooses complies with the purpose for which the procedural right

³ D. Chirică, *O privire asupra Noului Cod civil. Titlul preliminar*, in P. R. no. 3/2011, pp. 113-138.

⁴ F. A. Baias; E. Chelaru; Rodica Constantinovici; I. Macovei, *Noul Cod civil. Comentariu pe articole*, C. H. Beck Publishing House, Bucharest, 2012, p. 1238.

was recognized by law, does not damage the opponent in any way and does not affect the procedural rules that govern the entire civil proceedings⁵.

In terms of content, good faith, in the procedural sense, has both an objective material aspect, consisting in the exercise of the right within its material, objective limits to create a real benefit to its owner, and a psychological subjective aspect, which refers to the owner not being only after the chicane of the opposing party, its damage by exercising the said procedural right in a certain way or simply for the purpose to deviate the procedural rules governing the civil action⁶.

Good faith in French law

The obligation of good faith is laid out very clear in article 1134 of the French Civil Code. This is also the only explicit reference to this principle in the code. Thus, agreements legally formed have the force of law over those who are the makers of them. They cannot be revoked except with their mutual consent, or for causes which the law authorizes. They must be executed with good faith. It is clear from the formulation that it was intended to give an important role to the principle of good faith: once the contracts are formed, they have the force of law that must be executed with good faith. It appears to be a rather strong and somewhat rigid approach that the common law practice would not tolerate. There are certain comments to be made regarding the French formulation of the obligation of good faith. What would be criticizable is that there is no provision on the applicability of the principle of good faith during the performance of the contract. Therefore, the liability rests on tort principles during precontractual negotiations and on contract principles once the contract is formed.

It is true that art. 1134 states that contract must be executed with good faith, but there is no definition on the concept of good faith. According to art. 1135 agreements are binding not only as to what is therein expressed, but also as to all the consequences which equity, usage or statute gives to the obligation according to its nature. But this article brings nothing extra to clarify the concept of good faith. There is no provision which deal with good faith in case of fraud, error or lesion. Equity is such a comprehensive value, resulting in good faith approach from two perspectives, a subjective one, based on the discretions of parties, and a objective one, where the court's role is to determine whether a contract was performed in good faith⁷. We believe that these limitations can be explained by the fear that a too wide application of good faith can affect the freedom and the certainty of the legal relations.

Similar provision to those in French law can be found in the Swiss Civil Code, which in paragraph 1 of art. 2 states every person is bound to exercise his rights and fulfil his obligations in respect of the principle of good faith. Paragraph 2 of the same article states that the manifest abuse of a right is not protected by law. Hence, the concept of abuse of rights is defined in relation with good faith. The exercise of a right would be considered unfair if is used contrary to its purpose, this meaning contrary to good faith. In Swiss law the limitative function that one attributes to good faith is assured by the concept of abuse of rights. There is a division of competence between the two notions. The combined structure and the wording of art. 2 point to the necessity of judicial interpretation. Since the constitutive elements of abuse are violations of good faith and the manifest abusive exercise of rights, neither of these elements may be determined otherwise than by judicial interpretation. The implicit necessity of judicial interpretation does not make the determination of abuse contingent upon the allegation of the parties; on the contrary, by raising it into a question of both law and fact, the determination of abuse becomes the duty of the courts.

⁵ Elena Roșu, *Acțiunea civilă. Condiții de exercitare. Abuzul de drept*, C. H. Beck Publishing House, Bucharest, 2010, p. 181.

⁶ V. M. Ciobanu; M. Nicolae, *Noul Cod de procedura civilă. Comentat și adnotat*, volumul I, Universul Juridic Publishing House, Bucharest, 2013, p. 32.

⁷ A. M. Musy, *The Good Faith Principle in Contract Law and the Precontractual Duty to Disclose: Comparative Analysis of New Differences in Legal Cultures*, Global Jurist Advances, Volume 1, 2001, pp. 1535-1661.

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The Belgium Civil Code imposes the same requirement, that all contracts to be executed in good faith. Also, the contractual interpretations will be supplemented by good faith, custom and usage. Furthermore, the instances in which good faith applies have been expanded to several situations such as the formation of contracts where parties are obliged to act in good faith and the performance of contracts.

It is noted that neither the Belgian Civil Code does not define, even general, the concept of good faith. In this regard, legal literature points out two main applications of the principle of good faith: duty of loyalty and duty of cooperation⁸. Also in Belgium good faith is usually said to have three functions: an interpretative function (*fonction interprétative*), a supplementing function (*fonction complétitive*) and a restricting or limiting or mitigating function (*fonction restrictive, limitative, modératrice*)⁹. Sometimes a fourth function is distinguished that would allow the courts in certain circumstances to change the content of the contract, but this function, just as the *imprévision* theory, has not been accepted by the majority of authors and the courts¹⁰.

Good faith in German law

The nineteenth century in Germany is marked by the extent and depth of the Roman law studies, of its sources and of the Roman social and political institutions, seen both in their legal aspect and in terms of their historical development. As a result of these studies the concept of good faith developed from the Roman perception of *bona fides*. Subsequently, in the texts of the German Civil Code of 1900 the concept of good faith was introduced.

The German authors suggested for good faith the association of two terms as a unified expression for the concept in question: *Treu und Glauben*, which signifies loyalty and necessary trust in the legal documents and especially in conventions, and *guter Glaube*, which means false, excusable belief, protected as such, equivalent to a right. Good faith in these two forms is based on the loyal and honest intention. Good faith in the form of *guter Glaube* means to not do something illegitimate and is an affective and subjective state of mind¹¹.

Regarding good faith, the main issue is less about the object of faith (as trust) and more about how and what should be trusted and that the simple fact to be mistaken and believe (*irren und Glauben*) must be subordinated to a less subjective principle of rigorous loyalty, necessarily entailing an analysis full of reflection (*Pflicht der Überlegung*)¹².

As described, good faith takes the value of an ethical and legal concept, the psychological nature of the content of good faith being highlighted. The essence of good faith is unique and comes from morality¹³.

In German law, the concept of good-faith is governed by the German Civil Code (*Bürgerliches Gesetzbuch*) in art. 242 which states that the debtor has to perform his obligation according to the requirements of good faith. The principle of good faith has the status of a general clause which requires a positive or negative conduct, depending on the particularities of each contract.

German Civil Code it contains no express provision on *culpa in contrahendo* or on *neminem laedere*. In these situations good faith would be applied as a general principle of law. For instance, the German courts have appealed to the principle of good faith when it have been occurred a breach of a sales contract, the contractual parties failing to perform their obligations, such as delivery of the goods, conformity of the goods or payment of the price. Generally

⁸ J. Perilleux, *La bonne foi*, Journées louisianaises de la Nouvelle-Orléans et Baton-Rouge, Paris, 1994, p. 250.

⁹ J. Herbots, *International Encyclopaedia of Law – Belgium Law of Contracts*, Kluwer Law and Taxation Publishers, Netherlands, 1993, p. 149.

¹⁰ *Idem*, p. 251.

¹¹ K. G. von Wächter, *Die bona fides, insbesondere bei der Ersitzung des Eigenthums*, Edelman, Leipzig, 1871, p. 128.

¹² K. G. Bruns, *Das Wesen der bona fides bei der Ersitzung*, Berlin Puttkammer & Mühlbrecht, Berlin, 1872, p. 23.

¹³ Fr. Gorphe, *Le principe de la bonne foi*, Dalloz, Paris, 1928, p. 14.

speaking, in such cases the courts have to make their decisions on the basis of art. 242, but agreeably predictable and rational.

In legal German literature it had been made an effort to specify the theoretical status of art. 242 of German Civil Code¹⁴. The functions of good faith were assimilated to those which Papinian had attributed to the praetorian law. In a well-known passage Papinian had said: *ius praetorium est, quod praetores introduxerunt adiuuandi vel supplendi vel corrigendi iuris civilis gratia propter utilitatem publicam (...)*¹⁵. In the same way art. 242 reflects *iuris civilis iuvandi, supplendi sau corrigendi gratia*.

Similar to the *ius praetorium*, good faith has three functions:

- die sinngemäße Verwirklichung des gesetzgeberischen Wertungsplanes durch den Richter (*officium iudicis*);
- alle Maximen richterlicher Anforderung an das persönliche rechtsethische Verhalten einer Prozeßpartei (*praeter legem*);
- rechtsethische Durchbrüche durch das Gesetzesrecht (*contra legem*).

This trichotomy can be found also in Italian law, Dutch law and Belgian law, where good faith has the role to interpret, supplement and correct. In Greek law and Portuguese law good faith does have the same functions, although nowhere in the legal literature of these countries or in their legislation is expressly revealed the functions of good faith. These functions of good faith can be described as an attempt to understand how the principle of good faith does work in the United Nations Convention on Contracts for the International Sale of Goods (1980) and the UNIDROIT Principles¹⁶. This trichotomy can be regarded as a common core for European legislations.

Good faith in Italian law

The Italian Civil Code has been drafted after the German Civil Code therefore good faith is clearly defined and has a rather strong basis in the code. Provisions regarding this principle can be found in several articles. Thus, art. 1175 states that the debtors and creditors must behave according to good faith and fair dealing. Art. 1337 provides that parties must behave in good faith during the precontractual bargaining and contractual drafting. According to art. 1366 and art. 1375 contracts must be interpreted and executed in good faith.

These provisions show that the principle of good faith has a large applicability in Italian law, the duty of good faith being extended from the precontractual negotiations phase to the interpretation and performance. In Italian law good faith is similar to an ethical obligation which is an integral part of public policy.

The principle of good faith has a practical purpose, as honesty, fairness and social solidarity, this forcing the contracting parties to recognize the importance of good faith and to act reasonably¹⁷. In legal literature it is distinguished between a supplementing function (*funzione integrativa*) and an evaluating function (*funzione valutativa*) of good faith, both functions being recognized by the courts¹⁸.

Good faith in American law

The doctrine of good faith with regard to contractual relations has a relatively recent history in the United States. The American case is considered an exception among the common

¹⁴ F. Wieacker, *Zur rechtstheoretischen Präzisierung des § 242 BGB*, Tübingen, Recht und Staat, Heft 193/194, 1956.

¹⁵ Papinian, D. 1, 1, 7.

¹⁶ P. Schlechtriem, *Good Faith in German Law and in International Uniform Law*, Centro di studi e ricerche di diritto comparato e straniero, Saggi, conferenze e seminari, 24, Roma, 1997.

¹⁷ M. W. Hesselink, *The Concept of Good Faith*, The Hague, Boston & London: Kluwer Law International, 2004, p. 625.

¹⁸ Lina Bigliuzzi Geri, *Buona fede nel diritto civile*, Digesto delle discipline privatistiche: sezione civile, vol. II, ed. 4, 1988, pp. 171–172.

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law as the USA has a well developed doctrine of good faith, considering how little developed and commonly used is the concept of good faith in contractual relations.

Prior to the adoption of the Uniform Commercial Code (UCC), U.S. courts were slow in recognizing the doctrine of good faith in contractual relations. The doctrine of good faith received a boost when the UCC officially adopted the concept in the 1950's. By late of 1960's, U.S. courts began invoking a general requirement of good faith to afford relief for various forms of bad faith in contractual relations¹⁹.

The Uniform Commercial Code states in art. 1-203 that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement. The art. 1-201 comes to clarify the definition of good faith stating that good faith means honesty in fact in the conduct or transaction concerned. The doctrine finally came to age in the United States with the Second Restatement of Contracts in 1981. The Second Restatement of Contracts provides in section 205 that every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement. Therefore, good faith is defined as faithfulness to an agreed common purpose and consistency with the justified expectations of the other party. Section 205 goes on to state that good faith and fair dealing in the performance of a contract requires more than mere honesty.

The quoted articles clearly show that the emphasis is put on the performance, the enforcement and the process of negotiations of a contract appears to remain uncovered. Moreover, the American legal literature has pointed out that these articles do not deal expressly within the scope of good faith in commercial contracts, this leading to another definition of the concept of good faith²⁰. Thus, according to art. 2-103 from the Uniform Commercial Code good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

Although the existence of the doctrine of good faith in the United States can no longer be questioned, U.S. courts and scholars have mixed opinions about the doctrine. Good faith is a concept which brings chaos in contractual relations. It is difficult to identify the doctrine's precise parameters, this meaning that contractual obligations of the parties may be uncertain. Therefore, good faith should not be considered as a legal concept²¹. This theory is a groundless one, given that the nature of the concept of good faith depends on the particularities of each contract. The term good faith was not appropriately formulable in terms of some general positive meaning²². Instead, good faith was defined by the doctrine's function to exclude many heterogeneous forms of bad faith²³. The term of good faith also was defined by its function to limit the exercise of discretion in performance conferred on one party by the contract. Therefore it is bad faith to use discretion to recapture opportunities foregone on contracting, as determined by the other party's expectations or, in other words, to refuse to pay the expected cost of performing²⁴. The doctrine of good faith was criticised for being potentially too broad²⁵. It was generally agreed that the good faith doctrine only comes into play after a contract has been formed²⁶. U.S. courts and scholars have generally rejected such a duty in the negotiation phase of the parties contractual. The good faith doctrine does not require good faith in bargaining, good

¹⁹ R. S. Summers, *The General Duty of Good Faith – Its Recognition and Conceptualization*, 67 CORNELL L. REV., 1982, p. 812.

²⁰ A.E. Farnsworth, *The Concept of "Good Faith" in American Law*, Saggi, Conferenze e Seminari, 1993.

²¹ T. J. Dobbins, *Losing faith: extracting the implied covenant of good faith from some contracts*, 84 OR. L. REV. 227, 2005, pp. 228-231.

²² Summers, *supra* note 14 at pp. 819-820.

²³ E. A. Farnsworth, *Duties of Good Faith and Fair Dealing Under the UNIDROIT Principles, Relevant International Convention, and National Laws*, 3 TUL. J. INT'L & COMP. L., 1995, p. 59.

²⁴ S. J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV., 1980, pp. 369-373.

²⁵ A. Diamond; H. Foss, *Proposed standards for evaluating when the covenant of good faith and fair dealing has been violated: a framework for resolving the mystery*, 47 Hastings L. J., 1996, pp. 590-600.

²⁶ D. M. Patterson, *A Fable from the Seventh Circuit: Frank Easterbrook on Good Faith*, 76 IOWA L. REV., 1991, pp. 503-522.

faith in offer and acceptance²⁷. U.S. courts do not view it a function of the law to lead in matters of morality²⁸. Regarding all these theories, in American legal literature it has been argued the following point of view: if you offer a low price for some good to its owner, you are not obliged to tell him that you think the good is underpriced, that he does not realize its market value and you do. You are not required to be an altruist person. You are permitted to profit from asymmetry of information²⁹. This theory is an example of the traditional economic paradox that private vice can be public virtue.

The good faith obligation is to protect the reasonable expectation of the parties. The Uniform Commercial Code does not recognize an independent cause of action for failure to perform or enforce in good faith except in relation to a specific duty or obligation under the contract. Most U.S. courts have likewise refused to find an independent cause of action for breach of the good faith duty absent a breach of a specific contract term³⁰.

The doctrine of good faith does not apply until after a contract has been formed. The U.S. courts have generally applied the doctrine only with regard to contract performance and enforcement. Therefore, the U.S. conceptualization of the good faith doctrine focuses on its role to ensure that the parties will get the benefit of the bargain under the contract that they negotiated between themselves.

Good faith in Canadian law

Canadian jurisprudence has not produced a comprehensive, authoritative account of when the good faith term will be implied into the relevant contract. Canadian courts have not developed a comprehensive and principled approach to the implication of duties of good faith in commercial contracts. The Supreme Court of Canada in *Wallace vs. United Grain Growers* acknowledged that the obligation of good faith and fair dealing is incapable of precise definition, but that in an employment contract, this requires employers to be reasonable, honest and forthright with their employees and to refrain from engaging in conduct that is unfair or is in bad faith by being, for instance, untruthful or misleading³¹. In an insurance contract, the Supreme Court of Canada, in *Sun Life Assurance Company of Canada vs. Fidler*, decided that the duty of good faith requires an insurer to deal with its insured's claim fairly³². The duty to act fairly applies both to the manner in which the insurer investigates and assesses the claim and to the decision whether or not to pay the claim. In making a decision whether to refuse payment of a claim from its insured, an insurer must assess the merits of the claim in a balanced and reasonable manner. It must not deny coverage or delay payment in order to take advantage of the insured's economic vulnerability or to gain bargaining leverage in negotiating a settlement. This duty of fairness, however, does not require that an insurer necessarily be correct in making a decision to dispute its obligation to pay a claim. Mere denial of a claim that ultimately succeeds is not, in itself, an act of bad faith.

By way of contrast, in *Gateway Realty Ltd. vs. Arton Holdings Ltd.*, Court offered a more generic definition of good faith: parties to a contract must exercise their rights under their agreement honestly, fairly and in good faith. This standard is breached when a party acts in a bad faith manner in the performance of its rights and obligations under the contract. Good faith conduct is the guide to the manner in which the parties should pursue their mutual contractual objectives. Such conduct is breached when a party acts in bad faith, a conduct that is contrary to community standards of honesty, reasonableness or fairness.

²⁷ Summers, *supra* note 14 at p. 814.

²⁸ R. A. Posner, *Let Us Never Blame a Contract Breaker*, 107 Michigan L. Revs., 2009, pp. 1349-1357.

²⁹ Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 Michigan L. Revs., 2009, pp. 1357-1358.

³⁰ *Don King Productions, Inc. vs. Douglas*, 742 F. Supp. 741, 767 (S.D.N.Y. 1990).

³¹ G. England, *Employment Law in Canada*, 4th ed., vol. 2, Markham: Butterworths, 2005, p. 105.

³² Shannon Kathleen O'Byrne, *The implied term of good faith and fair dealing: recent developments*, The Canadian Bar Review, vol. 86, nr. 2/2007, p. 196.

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Legal Canadian literature has identified several possibilities as to how good faith might be defined³³. First of all, good faith requires one party to have regard for the other party's legitimate interests. The generality of the definition means that it may not provide sufficient guidance and an uncontextualized abstraction is difficult to apply to any given circumstance.

Secondly, analysing case law, it results that good faith might be defined as a sum of duties:

- the duty to exercise discretionary powers conferred by contract reasonably and for the intended purpose;
- the duty to cooperate in securing performance of the main objects of the contract;
- the duty to refrain from strategic behaviour designed to evade contractual obligations.

This approach of the concept of good faith is a useful one for the contracting parties given that a compilation of principles derived from the common law predicts what the general duty of good faith may mean in any particular circumstance.

There were attempts to define good faith after the doctrine of good faith as is found in the American Uniform Commercial Code. This approach does not capture the richness of common law. Taking a concept which already exists and then applying it to new circumstances can often fail.

Good faith should be regarded as being an excluder of bad faith, because it is easier to define bad faith than it is good faith and that such a focus will therefore make application of the doctrine more straightforward. Bad faith means a conduct that is contrary to community standards of honesty, reasonableness or fairness³⁴.

Regarding the application of the concept of good faith in commercial contracts, the Ontario Court of Appeal noted, in the case of *Transamerica Life Canada Inc. vs. ING Canada Inc.*, that Canadian courts have not developed a comprehensive and principled approach to the implication of duties of good faith in commercial contracts³⁵. The implication of a duty of good faith has not gone so far as to create new rights and obligations. Courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties or to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into. It results that the duty of good faith must be tied to the terms of the contract. In *Barclays Bank Plc vs. Metcalfe & Mansfield Alternative Investments* the Court has used the doctrine of good faith to police the bargain the parties have already made and to supervise performance of their contractual obligations³⁶. Even where good faith is not pleaded, courts have held that one contracting party owes the other an implied duty to carry out its obligations or to exercise any discretion in the contract in good faith. Contracts in which performance is dependent upon one party's exercise of discretion are characterized by an implied duty of good faith performance: the discretion must be exercised reasonably and in good faith and in light of the purposes for which it was conferred. The duty of good faith does not preclude self-interested behaviour and that a party under such a duty may be required to temper its self-interest, but not to avoid it. In *Georgian Windpower vs. Stelco* the Court stated that an agreement to negotiate in good faith is unenforceable on the basis that the concept is repugnant to the adversarial position of the parties when involved in negotiations. The Court concluded that an agreement to use best efforts to negotiate, like good faith, is similarly unenforceable. Such an agreement is uncertain and incapable of giving rise to an enforceable obligation. It is also contrary to the rationale behind negotiation that each party seeks to reach the most favourable agreement for them.

It is incontrovertible that good faith has two main sources in Canadian jurisprudence: first, good faith can be implied by operation of law and second, good faith can be implied by virtue of

³³ J. McCamus, *The Law of Contracts*, Irwin Law, Toronto, 2005, pp. 804-805.

³⁴ J. Swan, *Canadian Contract Law*, LexisNexis Butterworths, Markham, 2006, p. 650.

³⁵ F. P. Morrison; Hovsep Afarian, *Good Faith in Contracts: A Continuing Evolution*, Annual Review of Civil Litigation, Carswell, Toronto, 2004, p. 224.

³⁶ <http://www.lexpert.ca/magazine>.

the parties' intentions. It is also clear that Canadian courts have consistently rejected good faith as a generalized term which is automatically implied into all contracts, regardless of context. The Alberta Court of Appeal in *Mesa Operating Ltd. Partnership vs. Amoco Canada Resources Ltd.* noted that one should hold carefully to the distinction between the two sources of rules about contracts, the law and the contract. Sometimes a rule of law imposes a duty upon the parties to a contract despite their agreement. On other occasions the courts impose a rule upon the parties because conclude that this fulfils the agreement. In other words, the duty arises as a matter of interpretation of the agreement. The source of the rule is not the law but the parties. In such a context the term "good faith" in this case might blur that distinction.

Courts impose the good faith standard because the kind of contract being considered brings with it an inherent and therefore a reasonably predictable vulnerability in one party. This vulnerability is present at the time of contract, and this leads the courts to ensure that good faith is implied to balance out the unequal power of the parties. Once implied, the good faith will technically restrain both parties, but practically speaking, only the dominant party's behaviour is likely to be contested³⁷. In *Shelanu Inc. vs. Print Three Franchising Corp.*, the Ontario Court of Appeal followed the steps of the Supreme Court of Canada in Wallace's case, and taking into account the same reasons, recognized two kinds of contracts where good faith is implied by operation of law: employment contracts and franchise contracts. The Court imported a good faith term into the franchise contract because franchisee vulnerability set it apart from the ordinary commercial contract. Good faith is imported into these kind of contracts by operation of law not by virtue of the parties' intention.

In our opinion the good faith term should be used by the courts to limit a discretionary contractual power so that it is exercised reasonably and for the intended purpose, to ensure that the parties work to secure performance of the main objects of the contract and to insist that parties not evade contractual obligations.

Good faith in Australian law

The magnitude the concept of good faith took in North America was reflected in Australia, where the obligation of the contracting parties to act reasonably and honestly finds its equivalent in the good faith obligation, as the latter is perceived both in the European legal systems and in the USA.

It is generally thought that the decision in *Renard Constructions (ME) Pty Ltd v Minister for Public Works (1992)* started the development of good faith in contractual performance in Australia³⁸. The Minister for Public Works (the Principal) entered into two National Public Works Council contracts with Renard Constructions (ME) Pty Ltd (the Contractor) for the construction of pumping stations as part of a sewerage project in the Gosford area. After the Contractor commenced work, delays occurred and the Principal gave notice to the Contractor under Clause 44.1 of the contract calling on it to show cause as to why the Principal should not take over the work or cancel the contract. The Contractor responded indicating that the Principal had not yet supplied materials which under the contract it was required to supply and the work would be completed soon after its supply. The Contractor was instructed to proceed and further delays occurred. After concerns that the delays were due to poor workmanship the Superintendent recommended the Contractor be called upon to show cause under Clause 44.1 in respect of both contracts. Clause 44.1 conferred power to take over the whole or any part of the work or to cancel the contract. The Contractor indicated that it was willing and able to complete the contracts with a reasonable time and that it considered the action a repudiation of the contracts. The superintendent, who was not fully informed of the relevant circumstances by the Principal, recommended cancellation of both contracts and the Principal took over the remaining works. The matter was referred to arbitration, the Supreme Court and appealed in the New South Wales Court of Appeal on the grounds that the Principal was unreasonable in exercising its

³⁷ G. H. Treitel, *The Law of Contracts*, 11th ed., Sweet and Maxwell, London, 2003, p. 208.

³⁸<http://crisplegal.com.au/renard-constructions-me-pty-ltd-v-minister-for-public-works-1992-26-nswlr-234/>.

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power to take over the work and exclude the Contractor from the site, in breach of an implied condition of the contracts. The Court of Appeal held that Clause 44.1 should be construed as requiring the Principal to act reasonably as well as honestly in forming the opinion that the Contractor had failed to show cause to his satisfaction and thereafter in deciding whether or not to exercise the powers conferred; this derived from the ordinary implication of reasonableness, the provision for the Contractor to be given an opportunity to show cause against the exercise of the power and the provision enabling disputes to be referred to arbitration. The Court of Appeal also considered that the duty of good faith and equitable interference in the exercise of legal rights is relative to considerations of reasonableness. This case stands for the proposition that reasonableness may overlap and be indistinguishable from good faith. Accordingly, in the event of a Contractor's challenge to the reasonableness of a direction by a Principal, it is important to consider both the reasonableness of the Principal's actions and whether the Principal was acting in good faith.

Since *Renard*, good faith is not any more just implicitly used in Australia. Courts had to increasingly rule on the meaning of good faith with the help of an ever-increasing jurisprudence. Good faith has moved well beyond a vague concept of fairness³⁹. In *Alcatel Australia Ltd. v Scarcella* the Court noted that a duty of good faith both in performing obligations and exercising rights, may by implication be imposed upon the parties as part of a contract. In *Bond Corporation Pty. Ltd. vs. the Western Australian Planning Commission* the good faith has been given two divergent meanings. The first is a subjective view which requires inquiry into the actual state of mind of the person concerned. The second is an objective one based on the construction of words within a given legislative context. The first meaning as to the state of mind has been viewed as being imprecise and not capable of giving rise to an enforceable obligation. In this respect, in *Elizabeth Bay Developments Pty Ltd vs. Boral Building Services Pty Ltd* the Court noted that it is difficult to regard the parties as having undertaken in 1993 to declare at a future time that they had a commitment to good faith⁴⁰. The concept of a duty to carry on in good faith is inherently repugnant to the adversarial position of the parties. The role of good faith as a state of mind is to indicate what attitude and commitment parties exhibit to each other. Importantly are that actions or attitudes exhibited by one party on which rely the other party to make decisions. The courts should strive to give effect to the expressed agreements and expectations of those engaged in business, notwithstanding that there are areas of uncertainty and notwithstanding that particular terms have been omitted or not fully worked out. The effect of such endeavors is that certainty and predictability is maintained. It can be argued that the conduct of parties is determined by their state of mind. It is well established in Australian law that equity regulates the quality of contractual performance and that performance equates to conduct.

This leads to the second meaning of good faith, that good faith is viewed as a legal concept. In *Asia Pacific Resources Pty Ltd v Forestry Tasmania* the concept of good faith as a term in law was rejected because good faith can not be a pure question of law given that good faith is incapable of abstract definition and can only be assessed as being present or absent in relation between contracting parties. In order for a concept to be applicable an abstract definition is not required all the time. Good faith can be applied if the relevant facts are known or capable of being known. As a concept, therefore, good faith is tied to known facts or practical applications. The fact is that good faith does not need to be independently defined or reduced to a rigid rule. It acquires substance from the particular events that take place and to which it is applied. Good faith can be perceived as a general principle, according to which the parties must temper the deliberate pursuit of self-interest in situations where the conscience is bound⁴¹.

³⁹ B. Zeller, *Good Faith - The Scarlet Pimpernel of the CISG*, <http://www.cisg.law.pace.edu/cisg/biblio/zeller2.html>.

⁴⁰ *Ibidem*.

⁴¹ Jane Stapleton, *Good faith in Private Law*, Current Legal Problems, Volume 52, 1999, pp. 1-36.

Conclusions

In Romanian law, considerable endeavors were vested in aligning Civil Code provisions related to good faith with the Principles of European Contract Law and the UNIDROIT Principles. The Romanian law raises the principle of good faith to the level of public order, to the level of public order, as the parties cannot agree to limit or exclude it. Although the Romanian Civil Code tries to maintain a climate of legal certainty by its innovating elements related to good faith, there is uncertainty in classifying an action as compatible or not with good faith, which generates a certain legal insecurity for the one who must act in good faith.

Good faith remains an open concept which is encompassed by fairness and morality, a norm whose content cannot be established in an abstract way, but which depends on the circumstances of each case. In most legal systems good faith is given a central role, whether we consider the legal or social order. From the theoretical perspective the differences from a legal system to another can be major, but what prevails is the way in which the courts, whether judicial or arbitral, appreciate and apply the concept of good faith.

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