

The Duty of Good Faith in Common Law: A New View on Contemporary Contract Law

Abdullah, N.^{1*}, Hanafi, H.¹ and Murshamshul, M. K.²

¹*Department of Administrative Studies and Politics, Faculty of Economics and Administration, Universiti Malaya (UM), 50603 Kuala Lumpur, Malaysia*

²*Faculty of Law and International Relations, Universiti Sultan Zainal Abidin (UNISZA), 21300 Kuala Terengganu, Terengganu, Malaysia*

ABSTRACT

The concept of good faith encompasses the notion that all parties to a contract owe a duty to each other beyond those expressly provided by the terms of the contract. Good faith is a popular concept in civil law countries whereby good faith is clearly included in the civil law codes. However, good faith is gaining recognition in common law countries as well. Common law judges and scholars are divided concerning the desirability of qualifying the concept of good faith into Contract law. The objective of this paper is to analyse common law judges and scholars' perspectives on the application and interpretation of good faith. The paper is mainly a library-based research which uses a qualitative approach to analyse data. The findings show good faith had lately influenced common law, therefore, there is a higher chance for good faith to be a recognised and accepted as one of the legal principles of common law.

Keywords: Common law, contract law, good faith

INTRODUCTION

Good faith is a ubiquitous but poorly understood concept in contract law. There are many different interpretations of the

meaning of good faith, some of which are contradictory and confusing. The concept of good faith encompasses the theme that all parties to the contract owe a duty to each other beyond those expressly provided by the terms of the contract. In this context, it is expected that the contracting parties take into account other parties' interests when exercising their contractual rights. This is because the law of contract is viewed as a bargain that is made between the contracting parties, with the intention to make the

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E-mail addresses:

abd_hidayah@um.edu.my (Abdullah, N.)

hanira_hanafi@um.edu.my (Hanafi, H.)

msham@unisza.edu.my (Murshamshul, M. K.)

* Corresponding author

contract binding. For this reason, the court will try whenever possible to uphold bargains of contract through the duty of good faith to ensure the contract is executed fairly by the contracting parties.

The concept of good faith, which has its roots in civil law, has lately influenced common law. Because civil law has its origins in Roman law, this has directly influenced the continental system of law (David & Gary, 2006). Thus, the civil law legal system has been widely adopted in Europe, Latin America, Asia, Africa and the Middle East. The common law system however, originates from the English legal system.¹ There is a fundamental difference between civil law and common law legal systems. Civil law is based on codification, where its legal rules are predominantly written.

The role of the judge in the civil law system is limited to the interpretation and application of the law based on the civil law code. In common law, the legal rules are developed by judges through decisions of the court or based on the doctrine of a binding precedent. Both common law and civil law adopt two different legal systems. However, in the law of contract, there has been a tendency of common law lawyers to refer to the civil law (Nicholas, 1974). In civil law, the influence of Roman law can be

¹ These countries had been colonized by the British and used English law in their legal system. For example, United Kingdom (UK), the US (excluding Louisiana), Canada (excluding Quebec), Australia, New Zealand and other countries colonized by the British, including India, Hong Kong, Singapore and Malaysia.

traced to the law of obligation, particularly the law of contract. Therefore, there is a higher chance that good faith, which is rooted in civil law to have a big influence on common law lawyers pertaining to contract law.

This article elaborates the position of good faith in terms of its application through the use of *Bona Fides* in civil law, common law approaches to good faith and lastly, it outlines the varying perspectives of good faith in common law countries.

Civil Law Approaches to Good Faith: *Bona Fides*

Among the features of Roman law characteristic of the civil law system is *bona fides*. The concept of *bona fides* require that 'one's word must be kept', and 'one's conduct should be in exact conformity with it [promise]' (Turpin, 1965). Therefore, it is a kind of social and moral concept that regulates the relationship (Powel, 1956). The underlying theme of *bona fides* is to ensure justice and fairness is upheld regardless of the expressed intention of the parties to the contract.

Prior to *bona fides*, the concept of *strict juris* (formal contract) had already existed in Roman contract law. *Strict juris* is a concept whereby a judge is required to decide a contractual dispute according to the strict rules of the civil law (Hutchison, 1999). A right in the contract could only be applied when the right is expressly granted. Therefore, it is difficult to fulfil the requirement of *strict juris* when the right needs to be implied. However,

the requirement of *strict juris* seems of little value regarding the rights and duties concerning everyday dealings such as sale, letting and hiring, and especially those rights and duties which are not explicitly expressed but implied.

This concept caused problems when the plaintiff pleads breach of contract but is unable to assert a definite and express right in the contract. Therefore, there were problems with the use of *strict juris*. First, upon breach of a contract, according to *strict juris*, the issue must be defined in precise Latin words, sometimes invoking the Roman god (Hutchison, 1999). This situation was problematic to non-Roman citizens not well versed in Latin and who did not believe in the Roman gods. This made it difficult for non-Roman citizens to comply with the requirement that was set by the *strict juris*. Second, as early as the third century, with the expansion of business between Rome and other countries, there was a need for the court to provide adequate remedies for breach of contract. Therefore, in order to accommodate these two limitations, Roman law introduced the concept of *bona fides*.

There were procedural differences between the two concepts. In applying *bona fide*, the court has to consider other elements. For example, the circumstances of the case and parties' intention, compared with when applying *strict juris* which relies on the right given (O'Connor, 1990). The praetor (Roman magistrate) would always reject a remedy if the person seeking it was not in good faith, without having to show

any element of bad faith in the contract (Watkin, 1999).

The historical origin of *bona fides* within the Roman law has played a vital part in the acceptance of good faith within contemporary contract law in European civil codes. Most European civil codes contain a general good faith provision. In addition to that, some codes contain specific rules in which reference is made to the concept of good faith. *German Civil Code, Italian Civil Code, French Civil Code, Greek Civil Code, Swiss Civil Code* and the *Dutch Civil Code* all make reference to the concept of good faith. It is evident here that good faith has an important role in the civil law by its inclusion in the civil law codes which provides a strong position for the concept.

Common Law Approaches to Good Faith

Unlike civil law, there is no overriding general positive duty of good faith imposed on the parties to a contract either in negotiation or performance in common law. In *Walford v Miles*, Lord Ackner commented that a contractual clause containing an agreement to agree, or to negotiate in good faith, would not be enforceable, whereby the parties in the negotiation is entitled to pursue their own interest.²

This parallels the features of the common law itself, which is based on precedent. The development of good faith in common law stems from the English law through the Court of Chancery (Powell 1956). In the Court of Chancery, the first

² [1992] 2 AC 128,138.

Chancellors were ecclesiastics well versed in the Canon law. The principle of good faith is inherent in Canon law (the law of the Church of England). Therefore, the Canon law has been significant in the development of common law. In Canon law, it is emphasised that every promise was binding on the conscience of the person who made it and that failure or refusal to keep it was a breach of that person's duty to God (Powel, 1956). The jurisdiction of Common Law Courts over contracts was limited during the middle ages, and was no remedy for the breach of a simple contract. However, the Ecclesiastical courts were willing to enforce such contracts. For this reason, Common Law Courts issued writs of prohibition to prevent recourse to the Court of Chancery as a means to avoid conflict.

Due to the rapid development of international trade in the 13th century, a general remedy for breach of contract was needed. Even though there were many available statutes and petitions that were addressed to the King that called for contracts to be honoured, the statutes and petitions were insufficient to provide a remedy for breach of contract. In the 16th century, the Court of Chancery progressed and developed from a Court of Conscience to being a Court of Equity. This event led to the development of the concept of good faith. It also implies that the concept of good faith is separate from the concept of conscience (O'Connor, 1990). Thus, it would appear that the basic obligation of good faith arising from a promise or an agreement, which was enforced on grounds

of conscience in the Court of Chancery became the basis of the general remedy for breach of contract in common law. In view of this, it is beyond dispute that the Court of Chancery was mainly responsible for the development of good faith in common law.

By the 18th century, under the influence of Lord Mansfield, it appeared that good faith might have emerged as a broad principle of significance in English contract law (Atiyah, 2005). Lord Mansfield emphasised the basic fairness and intentions of the parties as governing principles. In his famous decision in *Carter v Boehm*, Lord Mansfield held that good faith is the central principle in a contract which 'good faith forbids either party from concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.'³

The position of English law with relation to the principle of good faith can be found in the landmark case of *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*,⁴ where Lord Bingham pointed out that in the Civil law, there is an overriding principle that parties in the contract should act in good faith. The principle of good faith is thus far more reaching than the simple requirement that parties should not deceive each other, the latter being a general duty "which any legal system must recognize".⁵ Despite good faith being a well-recognised principle in civil law legal systems and also in many common law legal systems, English law takes a different position. English

³ [1766] 3 Burr 1905, 1910.

⁴ [1989] QB 433.

⁵ [1989] QB 433,439.

law's preference for pragmatic solutions means that no such overriding principle of good faith has been adopted. The fact that English law does not recognise a duty of good faith does not mean that the rule of contract law does not generally conform to the requirements of good faith. Instead, English law responds to perceived cases of unfairness by developing piecemeal solutions in which good faith is implied.

References to good faith are increasingly found in both common law and legislation.⁶ In the insurance context, good faith is a well-known concept. The duty of good faith in insurance law was introduced almost 250 years ago in *Carter v Boehm*,⁷ in which Lord Mansfield commented that good faith is an important concept for disclosure.⁸ Later, the concept was codified in the *Insurance Contracts Act 1984* (Cth) by requiring the insurer and the insured to exercise utmost good faith in an insurance contract. Section 13 of the *Insurance Contracts Act 1984* (Cth) provide that 'A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith. Apart from insurance, good faith is also recognized in fiduciary, partnership and employment relationships where there is a 'special kind of relationship' established by the contract which carries an implied obligation of good faith via 'mutual trust and confidence'. In

this context, the special relationship requires trust and confidence that carries with it an expectation of utmost loyalty and good faith. The requirement of trust and mutual confidence was observed as 'the life-blood of the concern'.⁹ This is because they trust one another that they are partners in the first instance; it is because they continue to trust one another that the business goes on. From the above discussion, the pervasiveness of the concept of good faith in common law and legislation indicates that good faith behaviour is the expected norm.

View on Good Faith

To this date, the common law judges and scholars are divided as to the desirability of qualifying the concept of good faith in common law. Some common law judges and scholars welcome the concept of good faith in contract because it helps to overcome gaps in the contract. In Australia, Good faith was first put onto the judicial agenda through obiter comments by Priestley in the landmark case of *Renard* in 1992. His Honour held that a contract would be effective if both parties exercise reasonableness, which equates the duty of good faith.¹⁰ However, common law judges and scholars disagree with the introduction or acceptance of the concept of good faith of fear that it will override the essence of the contract. One who disagreed was Bristow who claims that 'defining the concept of what good faith actually encompasses is an exercise that frequently proves to be

⁶ [2004] FCAFC 16 [84]

⁷ (1766) 3 Burr 1905.

⁸ (1766) 3 Burr 1905, 1910.

⁹ *Helmore v Smith* (1886) 35 Ch D 436.

¹⁰ (1992) 26 NSWLR 234, 258.

frustratingly circular' (Bristow, 2000). The following discussion outlines the varying perspectives adopted in relation to the concept of good faith.

Views not in Favour of Good Faith in Common Law. The recognition of an implied duty of good faith has been seen as an unnecessary and undesirable judicial intervention, especially for commercial parties. English law takes the view that, in general, it is for the parties themselves to allocate risk through the terms of their contract, and it is not the role of the courts to do it for them. Thus, it gives freedom and autonomy to the commercial parties to the contract (Bristow, 2000). The court's duty is to respect and enforce the parties' intentions in the contract (Goff, 1984).

When parties bargain, there is an expectation of an outcome similar to the intention of the contract. Therefore, implying a requirement that the parties deal with each other in good faith may go against the parties' intention and consequently make the contracting process no longer reflect their intention. Contract law must provide parties with certainty (Bigwood, 2006). However, good faith creates uncertainty because it has no definite meaning. Good faith is often associated with the concept of honesty, reasonableness, fairness and cooperation. These concepts are believed to be too subjective and uncertain. Therefore, the concept of good faith has been described as a 'mystery' with its meaning susceptible to 'change' which shows that there is a lack of clarity around the concept.

Similarly, there is no general duty of good faith in the making of contracts in English law, in relation to performance as well as formation of contract (Atiyah, 2005). The underlying reason against the adoption of a general principle of good faith in English contract law is to apply a specific legal concept rather than to have a general principle to police unfairness. There are various specific legal concepts that clearly tackle issues of unfairness and injustice such as unconscionability, duty of cooperation, non-derogation from grant and fiduciary duty.

On the other hand, the common law has long been used to interpret parties' intentions to achieve a variety of normative results, with the aim of ascertaining the actual intention of the parties by looking at the typical intentions or expectations of the parties to the type of contract in question (Zimmermann & Whittaker, 2003). In this context, it means that the interpretation of expressed contractual terms or the implication of terms where one of the parties is held to be responsible to the other for defects in the subject matter of the contract, whereby some information was not disclosed before the contract took place will lead to legal consequences.

Views in Favour of Good Faith in Common Law. There is a need to have good faith as a universal term to act as a gap-filling term in the absence of express terms of the contract. This means the duty of good faith is a gap-filling term which supplements terms of a contract to

prevent uncooperative or unfair conduct in the course of performing a contract or exercising contractual powers. To exemplify this, a principal who engages a contractor to excavate a construction site provides in the contract that he [the principal] may terminate it following any specified breach of the contract by the contractor. This should of course be subject to the contract being given opportunity to show cause to the satisfaction of the principal why the contract should not be terminated. However, when the contractor breaches the contract but presents a reasonably good cause not to be terminated, the principal nonetheless decides the contractor is unreliable merely based on rumours that he had overheard about the contractor. The principal terminates the contract on the ground that the contractor has not met his/her satisfaction. Based on cases like the above, good faith is pivotal to the contracting parties in achieving cooperation and fairness as well as in the prevention of unfairness when express terms are absent from the contract. Good faith is therefore treated as an implicit expectation of the parties. Burrows (1968) further explained the function of good faith is used 'not only to condemn deception and lack of candour at the time a bargain is concluded, but also to require a forthcoming attitude, to condemn chicanery and sharp practice in the carrying out of contractual obligations'.

The legislature increasingly relies on good faith as a mechanism to achieve justice. There are more than 154 federal Acts that mention term good faith.¹¹ In legislation,

¹¹ [2004] FCAFC 16 [84].

there are two types of expressions to the concept of good faith, which are a) express and b) oblique. Express means a statutory obligation to act in good faith and oblique means good faith is a factor that has to be taken into account. An example of express good faith is found in s 13 of *Insurance Contracts Act 1984* (Cth). By virtue of the above, the requirement of good faith has been interpreted to mean that both parties, namely the insurer and the insured, must act with fairness and honesty, particularly when disclosing information to each other.¹² An example of oblique good faith is found in s 22(1) of the *Australian Consumer Law* as prescribed in schedule 2 of *Competition and Consumer Act 2010* (Cth). This section provides a list of factors, which the court may have to consider for the purpose of determining unconscionable conduct. One factor that needs to be taken into account is the good faith factor in clause (1) 'To the extent to which the supplier and the customer acted in good faith.'

The concept of good faith is widely employed at international levels, where many international trade instruments incorporate it. In *Nuclear Tests Case (Australia v France)*, the International Court of Justice claimed that 'One of the basic principles governing the creation and performance of legal obligations, whatever their source, is the principle of good faith'.¹³ In international sales law, good faith is used to promote uniformity as illustrated by Article 7(1) of the *United Nations Convention on Contracts*

¹² [1993] 7 ANZ Insurance Case 61-197 [78, 258].

¹³ [1974] ICJ REP. 253, 268.

for *International Sale of Goods*¹⁴, known as the Vienna Sales Convention (CISG). Good faith is also mentioned in the *Principles of International Commercial Contracts* (hereinafter UNIDROIT Principles 2004 in Article 1.7¹⁵, whereby good faith is the expected behaviours of the parties in the international commercial contracts. Indeed, the duty of good faith is also found in a number of articles of the UNIDROIT Principles 2004 which constitute a direct or indirect application of the principle of good faith and fair dealing in all phases of the contract.¹⁶

The Vienna Convention on the Law of Treaties guides interpretation of international treaties that include their

¹⁴ Article 7(1) of the *United Nations Convention on Contracts for International Sale of Goods (UNCITRAL)* stated that:

In the interpretation of the Convention, regard is to be had to its international character and the need to promote uniformity in its application and the observation of good faith in international trade.

¹⁵ Article 1.7 of the *Principles of International Commercial Contracts* (UNIDROIT Principles 2004) stated that:

In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade and prohibits the parties from limiting or excluding the duty in their contracts.

¹⁶ See for instance arts 2.arts 2.4(2)(b), arts 2.15, arts 2.16, arts 2.18, arts 2.20, arts 3.5, arts 3.8, arts 3.10, arts 4.1 (2), arts 4.2(2), arts 4.6, arts 4.8, arts 5.2, arts 5.3, arts 6.1.3, arts 6.1.5, arts 6.1.16(2), arts 6.1.17(1), arts 6.2.3(3)(4), arts 7.1.2, arts 7.1.6, arts 7.1.7, arts 7.2.2.(b)(c), arts 7.4.8 and arts 7.4.13.

formation and operation. Article 26 requires the performance of the treaties must be in good faith.¹⁷This means good faith is the foundation to the rules of pact sunt servanda.¹⁸ It is always an implicit expectation that whenever states enter into a contract, they have willingly committed themselves to its terms to ensure the successfulness of a contract. The Commission on European Contract Law produced the Principles of European Contract Law with an aim to harmonise the law of contract in the international business community by taking into account the requirements of the European domestic trade. The general obligation of good faith was clearly mentioned in Article 1.201(General Obligations)¹⁹. This is a clear indication that good faith is the basic principle which is required in the performance and enforcement of the contractual duties in the contract. Despite the differences in its purpose, these international trade instruments show that good faith plays an important role in international contracts.

¹⁷ Article 26 of *Vienna Convention on the Law of Treaties* (VCLT) '[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith'.

¹⁸ *pactasuntservanda* means agreements are to be kept; treaties should be observed. According to customary international law of treaties, *pactasuntservanda* is the foundation of international law. Without such an acceptance, treaties would become worthless.

¹⁹ Article 1.201(General Obligations) of the *Principles of European Contract Law* (Principles) stated that:

'[e]ach party must act in accordance with good faith and fair dealing and the parties may not exclude or limit this duty'.

CONCLUSION

It is interesting to discover that, despite good faith being rooted in Civil law countries by way of its inclusion in the civil law codes, good faith apparently has a huge influence in countries that practise the common law. There is an emerging interest in good faith in common law countries whereby many references to good faith in the common law and legislation have been made. Although the recognition of good faith in common law is mainly through piecemeal solutions, there is a strong positive inclination towards recognising the concept. Therefore, it is not surprising that there remains imbalanced views among common law judges and scholars towards the concept of good faith. However, this article has shown that good faith is widely used in common law, therefore there is a good likelihood for good faith to be a recognised and accepted as one of the legal principle at common law.

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