GOOD FAITH IN THE LEX MERCATORIA:
AN ANALYSIS OF ARBITRAL PRACTICE AND MAJOR
WESTERN LEGAL SYSTEMS

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LORENA CARVAJAL ARENAS

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ABSTRACT

This thesis is a comprehensive guide to the current interpretation of the principle of good faith in the lex mercatoria. It sets out the full background to this interpretation, exploring the development of good faith in major legal cultures in the Western world and in arbitral practice.

Modern lex mercatoria is one of the most conspicuous manifestations of globalization in the field of law. Previous examples of global law are the Roman *ius gentium* and the medieval law merchant. The principle of good faith has been fundamental in all these manifestations. The thrust of this thesis represents an investigation of the reasons for the essential role of good faith in universal contexts, and in particular, its meaning in the lex mercatoria.

It is argued here that national laws have been influential on the meaning of good faith in the current lex mercatoria. Hence, four major legal systems in the civil and the common law areas are studied: German, French, US and English. Nonetheless, other national systems are also mentioned throughout the thesis. This analysis will reveal the fundamental dynamism of the concept of good faith.

This thesis challenges the traditional view of good faith as a moral and subjective concept, impractical and difficult to assess. It will show that an objective notion of good faith is vigorous in international commerce nowadays.

This thesis explains that good faith in the lex mercatoria is interpreted as cooperation of the parties to a commercial contract. This notion fits the experience of global trade today. This theory will be verified through an analysis of: comparative legal history, sociological, philosophical and political theories, international instruments embracing the lex mercatoria and also through cases from national courts and international arbitration.

This comprehensive study will serve as a context for future investigations on ancillary duties that emanate from good faith and on the principle of good faith in specific stages of the contractual *iter*, such as re-negotiation of the agreement. It will contribute to the harmonization and unification of law in different regions of the world and also to global projects containing the language of good faith. Likewise, it will be useful for traders and practitioners, especially arbitrators dealing with good faith in international disputes between merchants.
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DECLARATION

Whilst registered as a candidate for the above degree, I have not been registered for any other research award. The results and conclusions embodied in this thesis are the work of the named candidate and have not been submitted for any other academic award.
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DEDICATED
TO
LORENZO AND GUILHERME
NOTE

The quotations from books, papers, judicial decisions and arbitral awards in Dutch, French, German, Italian, Latin, Portuguese and Spanish languages have been translated into English by the author of this thesis, unless specifically indicated otherwise.
ABBREVIATIONS AND ACRONYMS

ABGB: Österreich Allgemeines Bürgerliches Gesetzbuch (Austrian Civil Code)
Am.J.Comp.L.: American Journal of Comparative Law
Am.J.Int.Law: American Journal of International Law
Am.U.Int'l. L.Rev.: American University International Law Review
Arb.Int'l: Arbitration International
B.C.Int'l & Comp.L.Rev.: Boston College International and Comparative Law Review
BGB: Bürgerliches Gesetzbuch (German Civil Code)
Bracton L.J.: Bracton Law Journal
Burr: Burrow
BW: Burgerlijk Wetboek (Dutch Civil Code)
Cass.: Cassation/Cassazione
CIDIP: Inter-American Specialized Conferences on Private International Law
CII: Construction Industry Institute
CIF: Cost, Insurance and Freight
CLJ.: Cambridge Law Journal
CLOUT: Case Law on UNCITRAL Texts
CLP: Current Legal Problems
Co Law: Company Lawyer
Colum.J.Eur.L.: Columbia Journal of European Law
Col.J.Trans.L.: Columbia Journal of Transnational Law
Colum.L.R.: Columbia Law Review
Comp.L.Yb.Int'l Bus: Comparative Law Yearbook of International Business
Const.L.J.: Construction Law Journal
Cornell L.Rev.: Cornell Law Review
Corr.Giur.: Corriere Giuridico
CUP: Cambridge University Press
D: Justinian Digest
Denning L.J.: Denning Law Journal
DP: Dalloz. Recueil Périodique
ELJ: European Law Journal
ERCL: European Review of Contract Law
ERPL: European Review of Private Law
EU: European Union
f: Follow
FILJ: Foreign Investment Law Journal
FOB: Free on Board
Foro It.: Foro Italiano
Gaz.Pal.: Gazette du Palais
Harv.L.Rev.: Harvard Law Review
Hous.J.Int'l L.: Houston Journal of International Law
IBA: International Bar Association
IBL: International Business Lawyer
IBLJ: International Business Law Journal
ICC: International Chamber Commerce
ICCLR: International Company and Commercial Law Review
ICLQ: International & Comparative Law Quarterly
ICSID: International Centre for Settlement of Investment Disputes
I.L.Pr: International Litigation Procedure
ILR: International Law Reports
IMF: International Monetary Fund
Ind.J.Global Legal Stud.: Indiana Journal of Global Legal Studies
Int’l & Comp.L.Q.: International and Comparative Law Quarterly
Int’l L: International Lawyer
JBL: Journal of Business Law
J.Brit.Stud.: Journal of British Studies
JCL: Journal of Contract Law
JCP: Juris Classeur Périodique
JDI: Journal du Droit International
J.Int’l Arb.: Journal of International Arbitration
J.L.& Com.: Journal of Law and Commerce
J.Legal Stud.: Journal of Legal Studies
JWELB: Journal of World Energy Law & Business
JWTL: Journal of World Trade Law
KLJ: King’s Law Journal
Law & Soc’y Rev.: Law and Society Review
Liverpool L.Rev.: Liverpool Law Review
LI R : Lloyd’s List Law Reports
Lloyd’s Rep IR: Lloyd’s Law Reports Insurance and Reinsurance
LCIA: London Court of International Arbitration

LQR: Law Quarterly Review

LRAC: Law Reports, Appeal Cases (Second Series)

MLR: Modern Law Review


Mich. YBI Legal Studies: Michigan Yearbook of International Legal Studies

n: Note

n.: Number

NJV: Neue Juristische Wochenschrift

NSWLR: New South Wales Law Reports


OHADA: Organisation for the Harmonisation of Business Law in Africa

Ohio St.L.J.: Ohio State Law Journal

OJLS: Oxford Journal of Legal Studies

OUP: Oxford University Press


Pace Int'l L.Rev.: Pace International Law Review

Pap.: Papinian

PECL: Principles of European Contract Law

PICC: UNIDROIT Principles of International Commercial Contracts

Riv.Dir.Civ.: Rivista di Diritto Civile

Riv.Dir.Internaz.: Rivista di Diritto Internazionale

RPC: Reports of Patent, Design and Trade Mark Cases

RTD Civ.: Revue Trimestrielle de Droit Civil
s.l.: sine loco

SME: Small to medium-sized enterprise

S.M.U.L. Rev.: Southern Methodist University Law Review

Syracuse J.Int'l L. & Com.: Syracuse Journal of International Law and Commerce

Texas Int'l L.J.: Texas International Law Journal

Trans.Royal Hist.Soc'y.: Transactions of the Royal History Society


T.L.R. Times Law Reports

U.C.Davis L.Rev.: University of California, Davis, Law Review

U.Chi.L.Rev.: University of Chicago Law Review

U.C.L.R.: University of Cincinnati Law Review

U.Colo.L.Rev.: University of Colorado Law Review

UCP: Uniform Customs and Practice for Documentary Credits

Unif.L.Rev.: Uniform Law Review

U.Pitt.L.Rev.: University of Pittsburgh Law Review

Val.U.L.Rev.: Valparaiso University Law Review


Va.L.Rev.: Virginia Law Review

WLR: Weekly Law Reports


ZSS: Zeitschrift der Savigny Stiftung für Rechtsgeschichte (Journal of the Savigny Foundation for Legal History)
CHAPTER ONE – INTRODUCTION

1.1 BACKGROUND OF THE STUDY

It is said in the current climate of flourishing cross-border trade that divergences between national contract laws feature among those barriers which prevent the market from delivering its full potential. For this reason, the harmonization of contract laws is currently pursued in different regions of the world\(^1\) and also – with the same aim – it is proposed here that the lex mercatoria is being developed through contract practice, through regulations of self-governing associations of traders and is applied by arbitral tribunals.\(^2\)

This thesis surveys a core principle of the lex mercatoria – good faith – which has been called ‘The law of good faith’\(^3\) because of its presence in many institutions of private law (good faith is also a well-established principle of public international law). For example, good faith has been applied to contract law, inheritance law, company law, bankruptcy law and property law. In some jurisdictions, such as Quebec and Switzerland, the civil codes contain a general statement as regards this principle: ‘Each person’s rights shall be applied according to good faith’.\(^4\) The wide reach of this principle in an unwritten system, such as the lex mercatoria, implies the possibility of different interpretations by practitioners and arbitral tribunals. This could, however, lead to injustice, as the grievances of merchants could be dealt with in differing ways. The considerable scope of this principle might also lead professionals to dismiss the applicability of the lex mercatoria as an alternative to regulate the contract. This study will contribute to the current debate by establishing the meaning of good faith within this transnational legal system.

However, the discussions on good faith are not reserved to the lex mercatoria. Despite the fact that the principle is generally recognized in national laws from the civil law area and also in the commercial law of the US

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\(^1\) For example, OHADA in Africa; OHADAC in the Caribbean; and CIDIP in the American region. See the analysis of these attempts of harmonization in Chapter Four, Sections 4.5 and 4.6.

\(^2\) See Sub-section 1.1.1 of this chapter.


\(^4\) Article 6 of the Quebec Civil Code and article 2 of the Swiss Civil Code.
and in international instruments,\textsuperscript{5} there are still suspicions in professional circles about the meaning and reach of this general clause. For example, there is an ongoing theoretical debate on the acceptance of good faith in a number of common law jurisdictions,\textsuperscript{6} and also on the meaning of good faith and on other major issues related to it in the US law.\textsuperscript{7} Therefore, although the national perspective has been tackled by scholarship,\textsuperscript{8} it is considered in this thesis in its relation to the meaning of good faith in the lex mercatoria.

The core of this investigation, \textit{i.e.}, the examination of good faith in the lex mercatoria will be pursued through the analysis of international instruments representative of the lex mercatoria (Chapter Four) and of arbitral awards applying the lex mercatoria (Chapter Five). However, due to the arguable nature of the field in which this research is developed, the following sub-section undertakes an analysis of the literature on the existence, content and applicability of the lex mercatoria.

\textsuperscript{5} In this notion are included non-legislative means of harmonization of law, such as UNIDROIT Principles and PECL.

\textsuperscript{6} See the opinion of Justice Priestly in a decision by the Court of Appeal of New South Wales 12 March 1992: <http://cisgw3.law.pace.edu/cases/920312a2.html> accessed 30 April 2011. This opinion is mentioned in this thesis in Chapter Four, n 5 and accompanying text. See also \textit{United Group Rail Services Limited v Rail Corporation New South Wales} [2009] NSWCA 177 (3 July 2009) <www.austlii.edu.au> accessed 30 April 2011. This judgement upholds a favourable view about the enforceability of agreements to negotiate in good faith.

\textsuperscript{7} There are three major theories about the meaning of good faith in the UCC postulated by: Summers, Farnsworth and Burton. See the analysis of these theories in Chapter Two, Section 2.5.1. The discussion over the replacement of the doctrine of consideration by good faith has generated stirring interest. See, \textit{inter alia}, J Gordley, \textit{An American Perspective on the Unidroit Principles} (Centro di Studi e Ricerche di Diritto Comparato e Straniero, Roma 1996).

\textsuperscript{8} See Section 1.7 of this chapter.
1.1.1 LEX MERCATORIA

1.1.1.1 CONTEXT

The great impulse that international commerce has had in the last decades is evident. Numerous factors have influenced this dynamism: *inter alia*, the development of quicker and safer transport systems for goods, the development of technology that allows producers to offer services far away from the final receiver\(^9\) and the establishment of economic and political systems that welcome international commercial exchange.\(^10\) Commerce today is international by definition. Besides, informal electronic transactions are taking the place of vis-à-vis contracts, requiring responses from the law according to the new way of trading internationally.

The globalization of commerce has determined a process of global law creation.\(^11\) Further to the international exchange of goods and services as the economic foundations of the lex mercatoria, Schmidt-Trenz holds that international trade is something similar to the original state described by Hobbes, that is, a chaos because of the absence of a centralized state power. Such a situation can be overcome by private agreements that allow the equilibrium and confidence in the fulfilment of assumed obligations. The author calls this ‘co-operation in the absence of government’.\(^12\)

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\(^9\) A fundamental technology advance is internet. See Gautrais and others in ‘Droit du Commerce Électronique et Normes Applicables: La Notion de Lex Mercatoria’ (1997) Revue de Droit des Affaires Internationales 547, 568. Gautrais notes that, ‘The experts in the business community, on the internet or elsewhere, forget that the convention thus formed is a juridical act. The trivial nature of the exchange, the moderateness of the engagement and the user-friendliness of the communication, are removing the sacred aura surrounding the operation’.

\(^10\) Countries with governments from the entire political spectrum form part of major regional economic organizations such as: EU, MERCOSUR and NAFTA. See F Di Mauro, S Dees and W McKibbin (eds), *Globalisation, Regionalism and Economic Interdependence* (CUP, Cambridge 2008).


Hence, the present stage of good faith in international transactions is determined by the momentum of the lex mercatoria.\(^\text{13}\) The purpose of this section is to describe this legal phenomenon. Besides the descriptive approach, a normative perspective is also assumed, as this study will not remain neutral on the existence and advantages of the lex mercatoria.\(^\text{14}\)

As a matter of fact, many times differences between national legal systems – which were made for internal purposes – hinder the negotiation and the solution of disputes related to transnational commercial operations. Many attempts have been made by states to solve this through conventions that seek to harmonise the law in particular areas, \textit{e.g.} international sales of goods or bills of exchange.\(^\text{15}\) However, these kinds of regulations are always insufficient and do not reach the goal of uniform criteria due to the unwillingness of states to concede on the many aspects that they consider to represent their legal culture or national interests. The commissions usually come across with compromising formulae – as the one contained in article 7 of the Vienna Sales Convention as regards good faith\(^\text{16}\) – which did not solve concrete issues of trade.

As a result, the ‘practical law’ of economic operators – made by practices, usages and standard contracts – has started to regulate trading relationships, thus reviving the lex mercatoria. For example, the lex mercatoria is enshrined nowadays in international principles, conventions and general terms as INCOTERMS.\(^\text{17}\) However, these manifestations do not exhaust the lex mercatoria, whose main sources are the custom and practices of the

\(^{13}\) It is worth pointing out that this study is unavoidable for someone wanting to know the significance of good faith in international commerce in our day. At the same time, someone wanting to study the lex mercatoria cannot avoid referring to good faith, since this is one of the inspiring principles of the lex mercatoria: ‘Lex mercatoria requires that contracts are performed in good faith’ ICC award n. 5904 (1989) 115 JDI 1107. Original in French.

\(^{14}\) However, renowned authors do not take sides. See, \textit{inter alia}, U Draetta, R Lake and V Nanda, \textit{Breach and Adaptation of International Contracts. An Introduction to Lex Mercatoria} (Butterworth, Salem 1992) 3: ‘Although we are neutral as to the theoretical existence of the lex mercatoria…’


\(^{16}\) See Chapter Four, section 4.1.

\(^{17}\) Certain terms have been in INCOTERMS for a long time (first version 1936) while others have to settle down and establish as usages, therefore, in the terms of Goode, they are ‘evidence of existing usage or a fashioner of new usage’. R Goode, ‘Usage and its Reception in Transnational Commercial Law’ (1997) 46 Int’l & Comp.L.Q. 1, 26.
mercantile, shipping and insurance enterprises of all countries. Normally, the
general practices and usages of particular sectors of commerce have been
acknowledged by professional organizations of traders and included in model
contract forms and general conditions. For example, in the construction
industry the *Fédération Internationale des Ingénieurs Conseils* (FIDIC) has
adopted a number of model contract forms;\(^1\) this has also been done in
Britain with the contract forms of the Grain and Feed Trade Association
(GAFTA) and those of the Federation of Oils, Seeds and Fats Associations
(FOSFA).\(^2\) Other professional organizations of commodities traders also
have adopted standard contracts and other forms of standard law making.\(^3\)
These limited examples show that the lex mercatoria tends to evolve and
adapt according to different contexts of business and regions. As a result, the
general term lex mercatoria has become lex maritima,\(^4\) lex petrolea,\(^5\) lex
electronica\(^6\) and lex constructionis,\(^7\) according to the particular sector in
which it is applied.

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\(^1\) See R Knutson and W Abraham, *FIDIC: An Analysis of International Construction Contracts*
(Kluwer, The Hague 2005). The importance of the FIDIC conditions of contracts has been enhanced by the issuance of
the new World Bank guidelines for procurement, which are incorporated in the Bank’s loan
agreements with its borrowers, who must use its Standard Bidding Documents (SBDs), based
upon the FIDIC form of contract conditions (the Red Book). See Guidelines: Procurement
under International Bank for Reconstruction and Development Loans and International
Development Agency Credits of May 2004 (revised October 2006)
accessed 19 February 2010.

\(^2\) A request was made to FOSFA for an example of these standard form contracts. This was
refused. Statement by Anna Baran on behalf of FOSFA’s Chief Executive (Personal email
correspondence 4 March 2011).

\(^3\) See F De Ly, *International Business Law and Lex Mercatoria* (TMC Asser Instituut, North-
Holland 1992) 188.

& Com. 105.

\(^5\) See D Bishop, ‘International Arbitration of Petroleum Disputes: The Development of a “Lex
In this article the author reports several arbitral cases in which principles emanating from
the world-wide custom and practice in the oil business have been applied.

UC Berkeley: Berkeley Center for Law and Technology
<http://www.escholarship.org/uc/item/0467105j> accessed 17 February 2010. See on the
importance of the custom in cyberspace and, particularly, on the role of usages in the lex
electronica: Gautrais and others (n 1).

\(^7\) C Molineaux, ‘Moving Toward a Construction Lex Mercatoria, A Lex Constructionis’ (1997)
14 J’Int’l Arb. 55.
1.1.1.2 THE ADVENT AND THE REVIVAL

During the Middle Ages the lex mercatoria appeared as a body of international customary rules governing the cosmopolitan community of merchants who travelled all around Europe. This law was produced by an autonomous merchant class in order to regulate its own affairs without reference to the law of the land and/or to coercion. 25

Röder, who supports the idea of a medieval law merchant, claims, however, that ‘theories on the unbroken connection between the old lex mercatoria and the new transnational business law of the twentieth century must be contested. Perhaps the principal objection lies in the differences between the legal sources’. 26 Such an objection should be welcomed if the limited reach of the old law merchant governing the transactions of solely European traders is considered. 27 However, it must be remembered that European traders exported their ideas to their new empires and beyond as they dominated trade until recent times.

What is important for the purpose of this thesis is to know, firstly, whether customs and practices of merchants were, in fact, applied as distinct from the law of the town. Secondly, it is also important to establish if there was uniformity on underlying principles, especially on good faith. Could good faith be considered a principle of the medieval lex mercatoria?

As regards the first aspect, it is worth recalling the thinking of Mitchell at the beginning of the twentieth century, who agreed that the law merchant, in fact, was vague and indefinite, but in spite of its vagueness the law merchant existed: ‘In every commercial country in Europe there were rules and legal doctrines for merchants and mercantile transactions that were

regarded alike by merchants and by jurists as distinct from the common law of the land’. 28

The ‘law merchant’ of medieval times was the system of rules actually enforced in the commercial courts and actually observed by merchants in their dealings. This lex mercatoria is regarded as having possessed certain uniformity in its essential features; first of all, it was mainly based on custom. In spite of the luxury of formulae that many agreements had during the Middle Ages, both Church and mercantile usage laid stress upon the binding force of a verbal promise. 29 Only for the sake of evidence and, to prevent misunderstandings, contracts were generally committed to writing. Under the influence of the notaries a uniform legal phraseology – *stylus mercatorum* – was introduced into the commercial documents of Southern Europe, and this uniformity of language did much to fix and generalize mercantile customs.

In England, particularly, the Bristol Treatise on the lex mercatoria shows clearly that the force of custom was recognised. It is possible to read therein ‘Set apponitur adhuc le affidavit propter antiquam consuetudinem’. 30

As regards the second aspect, that is, whether there was uniformity on underlying principles, good faith and the lex mercatoria were utterly united during this period in which Western mercantile law assumed the character of an integrated system of principles, concepts, rules and procedures. The principle of good faith already present in all legal systems of the time was adapted to the special needs of the mercantile community, *i.e.*, to the system of commercial credit, which was invented in this period, and to the business associations of that time: *commenda* 31, *compagnia* 32 and various other forms

29 Mitchell indicates that, ‘The idea of good faith, an idea urged by the Church and supported by the merchants, did more than create a rule protecting the honest purchaser in market and fair. Slowly it undermined the Roman and Germanic principle that in general formless contracts are not binding’. Ibid 102. ‘In the 14th century the validity of nuda pacta in commercial transactions was recognised in Italy by mercantile usage, and it seems probable that in commercial and local courts they were recognised in England’. Ibid 105.
30 It is a call to apply the old custom. *The Little Red Book of Bristol*, vol. I. c. 4, p. 60.
31 *Commenda* is a contract whereby one partner of a joint venture travels over sea and trades the common goods while the other stays at home and is involved only as an investor. Source: A Cordes, ‘The Search for a Medieval Lex Mercatoria’ (2003) Oxford U Comparative L Forum <http://ouclf.iuscomp.org> text after n. 41 accessed 28 April 2011.
32 Medieval *compagnie* were associations of merchants, ship-owners, owners of productive activities and bankers who traded goods. Generally, a wealthy family was in charge. They had also a network of agencies and subsidiaries in Europe and in the Middle East. The height of
of commercial partnership.\textsuperscript{33} Good faith was reflected in all these agreements of partnership and credit which imply trust in the other party.\textsuperscript{34}

From medieval times, the lex mercatoria evolved to a second stage that occurred with the creation of sovereign states and the nationalization of law in the seventeenth to nineteenth centuries. In this period the lex mercatoria lost its practical orientation and international character.\textsuperscript{35}

Two emblematic examples of incorporation of the law merchant into the general law of nations are France and England. In the former the incorporation was accomplished by legislation; in England, by judicial precedent:

In France codification of commercial law on a national scale was first carried out by the \textit{Ordinance sur le commerce} of Louis XIV of 1673 and Colbert's \textit{Ordinance de la marine} of 1681. A revision of this legislation was commenced in 1787 but was interrupted by the French Revolution. Only at the beginning of the nineteenth century was work resumed and in 1807 the Code de Commerce, one of the five great codes of Napoleon, was enacted ... In England the incorporation of the law merchant into the common law was largely carried out by two Chief Justices, Sir John Holt, who officiated from 1689 to his death in 1710, and Lord Mansfield who was Chief Justice from 1756 to 1788.\textsuperscript{36}

The third and contemporary stage of the lex mercatoria begins with the boosting of the idea of globalization of commerce.

Globalization is a phenomenon highlighted as a characteristic of our era of information technology and increased international trade and mobility.\textsuperscript{37}

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\textsuperscript{33} See \textit{The Companion to British History} (Routledge, London 2001) 350.
\textsuperscript{34} See n 29.
\textsuperscript{36} Schmitthoff (n 35) 5.
\textsuperscript{37} For a critical view about the modern process of globalization, see J Harold, 'Lessons from History' (2003) \textless http://yaleglobal.yale.edu/display.article?id=886\textgreater accessed 27 March 2008. See also J Kunstler, 'Globalization is an Anomaly and Its Time is Running Out' (2005) \textless http://yaleglobal.yale.edu/display.article?id=6104\textgreater Harold and Kunstler have a North American view of the phenomenon. They state, basically, that the pillars of globalization – world peace and interdependence between countries – make, at the same time, this process vulnerable. The peace experienced a great setback with the attacks of 11\textsuperscript{th} September where 'every part of the package that had previously produced such an unprecedented economic
It is not, however, a recent development; on the contrary, it existed from ancient times.\textsuperscript{38}

The Roman and Mongol Empires are examples that confirm this view.\textsuperscript{39} The Roman Empire had an active trade flow within the regions which formed the great Mediterranean world. The expansion of the mercantile economy when Rome developed maritime supremacy introduced in the law a determining element: good faith, which was a source of new institutes and a complex of contractual relations. These appeared as a reflection of the social reality existing between Roman citizens and \textit{peregrini} (those who were not Roman citizens). In this context there emerged a new \textit{ius} in contrast to the traditional \textit{ius civile} and at the same time part of it, called \textit{ius gentium}, defined as \textit{ius gentium est quod naturalis ratio inter omnes homines constituit} (Gaius I, 1),\textsuperscript{40} whose centre was the international trade.\textsuperscript{41}

In modern times, practitioners have developed their own ‘third legal order’ because certain areas during the process of industrialization (nineteenth and early twentieth centuries) and globalization (second half of the twentieth century) were simply not covered by national or international law. The expansion of transnational activity put intense pressure on states to recognize and adapt to the special needs of long-distance trade. According to the experts, the main failing of national laws is that they were incapable of regulating the changing events of international trade.\textsuperscript{42} Under the dynamics of rapid and fundamental changes, national law and economic needs drifted apart. Thus, the international community started to regulate itself by standard contract forms and regulations of self-governing associations of traders.\textsuperscript{43} The first areas of commercial activity to begin systematically developing their own growth in many countries – the increased flow of people, goods, and capital – now seemed to contain obvious threats to security’ (Harold). In the same way, the interdependence would be seeing its sunset with the oil-short future.


\textsuperscript{40} The law of nations is the law which natural reason has established among all humankind.

\textsuperscript{41} See P Cerami and A Petrucci, \textit{Lezioni di Diritto Commerciale Romano} (Giappichelli, Torino 2002) passim.


\textsuperscript{43} Cf. n 17, 18 and 19 and accompanying text.
rules of contract were the insurance and the transport industries. Röder calls this phenomenon ‘the “colonization” of contract law by businessmen and companies’. Following this trend, arbitral awards referred to international principles accepted by traders around the world in order to substitute for the paucity of regulation. These are manifestations of the renaissance of the lex mercatoria.

Municipal law has shown its weakness in regulating international trade. On the one hand, the law of a particular state might be too undeveloped to cope with the challenges that a multilateral agreement with numerous embedded contracts presents. On the other hand, the private parties to a contract are not well-disposed to submit the solution of an eventual dispute to the law of the other party and, a fortiori, to the law of the host state in the case of a foreign investment agreement. These factors have favoured the development of business practices and sector regulations. Therefore, the lex mercatoria has gained ground in international trade.

It must be recognized, however, that the choice of the lex mercatoria in lieu of national law in the contract is still very rare; as also is the exclusive application of the lex by arbitrators.

Nonetheless, the reality demonstrates that awards based on the lex mercatoria have not been set aside by national courts. For example, in 1987 the English Court of Appeal, on the application of the lex petrolea, held that, ‘By choosing to arbitrate under the rules of the ICC and, in particular, article 13.3, the parties have left proper law to be decided by the arbitrators and have not in terms confined the choice to national systems of law’. It must be

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44 Röder (n 26).
45 The reasons for this are, among others, lack of knowledge of the other legal system, additional costs associated to the application of a foreign system and perceived disadvantage.
48 The term lex petrolea makes reference to a particular branch of the universal lex mercatoria applicable to the oil industry.
clarified that article 13.3 Rules of Arbitration of the ICC is today’s article 17, which refers to the ‘Rules of Law’ applicable to the merits of the dispute. It has been widely recognized that these ‘Rules of Law’ include the lex mercatoria, in other words, article 17 of the ICC Rules (former article 13.3) allows the application of the lex mercatoria. Furthermore, there is an old well-known decision related to the lex mercatoria and good faith: NORSOLOR v PABALK. The case arose out of a dispute between a French Corporation (NORSOLOR) and a Turkish Company (PABALK) following the termination by NORSOLOR of an agency contract with PABALK. The contract provided for ICC arbitration, but it did not specify the applicable law. PABALK instituted arbitral proceedings seeking damages for the termination of the contract. An arbitral tribunal was constituted in Vienna. The absence of a stipulation of the law to be applied caused the arbitrators to consider whether they should apply Turkish law (as lex loci executionis), French law (because it was the law of the principal’s establishment), or the law with which the contract was substantially connected. The arbitrators found that the terms of the contract gave no clue as to which law should apply. Taking into account the international character of the contract, the arbitrators decided to disregard domestic laws, whether Turkish, French or other law, and to apply the ‘international lex mercatoria’. They held that one of the principles of the lex mercatoria was the principle of good faith and that, by application of the principle, NORSOLOR should be held responsible for the termination of the contract, entitling PABALK to damages. The decision was annulled by the Court of Appeal of Austria which considered lex mercatoria ‘a world law of uncertain validity’. The Supreme Court of Austria quashed the decision of the Court of Appeal, holding that, if the award referred to the lex mercatoria, it was based on the principle of good faith, which is an ‘inherent principle of private law’ and that it was not, therefore, contradictory to the provisions of either Turkish or French law.

The lex mercatoria appears legitimated by the evidence of its usefulness and not by the imposition of any national or international authority.

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50 See the analysis of article 17 of the ICC Rules below in this chapter (text after n 158).
whatsoever. Here, a remarkable example of its usefulness is what Dasser metaphorically qualified as ‘omnipotence’, because ‘there are few contractual cases that cannot be solved solely with the two complementary principles: pacta sunt servanda (promises ought to be obeyed) and good faith’ (parenthesis added). However, the content of this phenomenon is still arguable. Accordingly, the different positions on the existence and on the concept of the lex mercatoria are explored in the following sub-section.

1.1.1.3 THE DEBATE ON THE EXISTENCE OF THE LEX MERCATORIA

The views of academics, arbitrators and of judges fall mainly into two groups: those who uphold the existence of the lex mercatoria and those who deny its existence as an autonomous legal order.

The first group supports the existence of the lex mercatoria. These authors, in general, agree that the expansion of business has revealed the shortcomings of national and international law and, consequently, that it has prompted the development of the lex mercatoria. However, many authors within this group recognize that the lex mercatoria could not exist without the complement of national and international law. Among them, Maniruzzaman considers that the lex mercatoria does not reach those standards of domestic

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52 Besides, some national statutes have acknowledged the application of the lex mercatoria by arbitrators: article 1496 of the Nouvelle Code de Procédure Civile in France; and also Dutch law. See the analysis of these norms below in the text that accompanies n 160-1.
53 Dasser (n 46) 133. See, however, P Mayer, ‘Le Principe de Bonne Foi devant les Arbitres du Commerce International’ in C Dominicé, R Patry and C Reymond (eds), Études de Droit International en l’ Honneur de Pierre Lalivé (Helbing & Lichtenhahn, Bâle/ Francfort-sur-le Main 1993) 555, who states: ‘The omnipresence of the good faith principle in the lex mercatoria does not appear to constitute an asset’.
54 See a good record of legal and scholarly positions on the lex mercatoria in De Ly (n 20).
55 See T Carbonneau (n 42) passim. Among the contributors who are against the Lex Mercatoria: F A Mann, G Delaume and K Hight; among the supporters: B Goldman, A Lowenfeld and F Juenger.
56 There are many particular positions within this group of authors, e.g. Hight in ‘The Enigma of the Lex Mercatoria’ in Carbonneau (n 42) 134, relies on the existence of the lex mercatoria but not as a system of law. For him, ‘The concept of principia mercatoria more correctly reflects the nature, application and content of the law merchant than any suggestion that it amounts to an inchoate or undiscovered legal system that exists outside national jurisdictions’. Furthermore, Schmitthoff in The Unification of Law of International Trade (Akademiförlaget-Gumperts, Gothenburg 1964) sees the lex mercatoria as a synthetic concept embracing similarities among various national legal systems. He is one of the main exponents of the so-called ‘Positivist view’, which considers the lex mercatoria having existence only through the state’s acknowledgement, giving effect to conventions and uniform laws.
legal regimes or public international law in order to regulate integrally a contractual relationship.\textsuperscript{57} Lowenfeld supports also this view: ‘In each of the cases I have mentioned, lex mercatoria supplies the solution to a particular issue, without necessarily governing all aspects of the transactions’.\textsuperscript{58}

Lowenfeld considers that the lex mercatoria is an additional option in the search for the applicable law.\textsuperscript{59} The following illustration provided by Lando helps to understand such a meaning:

Suppose that a Scandinavian seller has sold goods to a German buyer which are supposed to have a long life, and the buyer notices the defect after both the German (6 months) and the Scandinavian (1 yr) periods of limitation have run. An arbitrator might say, I need not decide between German and the Danish law, because under either one the claim is barred. Alternatively, the arbitrator might determine that both the German and the Scandinavian statutes were designed for internal transactions only, and might look to the Vienna Sales Convention for guidance.\textsuperscript{60}

It is not certain whether this example was taken from reality; nonetheless it is possible to assert that the ICC award n. 5713 of 1989 has the same factual background and legal rationale.\textsuperscript{61} Goode, commenting on this case, criticizes the use of the Convention to solve the controversy as an expression of a general usage of the trade (\textit{i.e.}, as an expression of the lex mercatoria) for several reasons, \textit{inter alia}, the fact that the contract was concluded in 1979 when the Convention did not even exist; and also because article 39 related to the controversy was highly debated, so it could hardly express a \textit{usus} and \textit{opinio iuris} – the features of a binding usage in international commerce.\textsuperscript{62} With this case Goode justifies his criticism of the willingness of arbitrators to resort to Conventions as manifestations of

\textsuperscript{58} A Lowenfeld, ‘Lex Mercatoria: An Arbiter View’ in Carbonneau (n 42) 84-86.
\textsuperscript{59} Ibid.
\textsuperscript{60} Ibid 81.
\textsuperscript{62} See the analysis of customs and usages as sources of the lex mercatoria below in this chapter.
consecrated usages.\textsuperscript{63} It is important to note that Goode is an advocate of the lex mercatoria. He points out that, ‘To the extent that the lex mercatoria represents general principles of law common to relevant States there seems no reason why it cannot be applied as the proper law governing the substantive rights of the parties’.\textsuperscript{64}

Some authors even defend the prominence of the lex mercatoria against the chosen law. Carbonneau is a leading voice in this first group:

The application of any law designated by the parties must be tempered by reference to commercial usages, which now are being progressively formalized into the basic tenets of the lex mercatoria. In any given international arbitration, the arbitrators can modify provisions of the governing law and adapt them to the rules and principles of the arbitral international law merchant.\textsuperscript{65}

Tetley, with the excellent example of lex maritima, asserts the existence of the lex mercatoria in this area. He justifies his view with the history of the lex maritima, \textit{e.g.} the general average\textsuperscript{66} is an example of lex maritima dating back to the Rhodian Law 800-900 BC. A modern lex maritima does exist in international bills of lading, charter party forms, marine insurance and in universal terms and practices throughout the shipping world; these instruments are applied by arbitrators as part of the lex mercatoria regardless of national law or international convention.\textsuperscript{67}

Tetley’s contribution acts as a good counter-argument to the wide view of Carbonneau. It appears that the arbitrators do not set aside the chosen law or correct it with the lex mercatoria, but most of the time the matter is regulated by national law allowing the application of international contract

\textsuperscript{63} Goode (n 17) 20.
\textsuperscript{64} Ibid 29.
\textsuperscript{65} T Carbonneau, ‘A Definition of and Perspective upon the Lex Mercatoria Debate’ in Carbonneau (n 42) 21.
\textsuperscript{66} Average means the apportionment of financial liability resulting from loss of or damage to a ship or its cargo. The origin is from late 15th century French avarie ‘damage to ship or cargo’, earlier ‘customs duty’, from Italian avaria, from Arabic awār ‘damage to goods’; the suffix age is on the pattern of \textit{damage}. Originally denoting a duty payable by the owner of goods to be shipped, the term later denoted the financial liability from goods lost or damaged at sea, and specifically the equitable apportionment of this between the owners of the vessel and of the cargo (late sixteenth century); this gave rise to the general sense of calculating the mean (mid eighteenth century).
\textsuperscript{67} See W Tetley, ‘The Lex Maritima’ in Carbonneau (n 42) 43.
practice or commercial customs. Municipal systems of law do not regulate the subject in another way because to do so could obstruct the normal progress of contracting. In other words, a different regulation could mean a forced solution to what is normally assumed as binding. This phenomenon is, ultimately, what it is called lex mercatoria. Here, Berman and Kaufman note:

International trade terms relating to allocation of risk of loss or damage to goods, clauses of bills of lading – in marine insurance policies, certificates and in letters of credit –, arbitration clauses and other devices used in export and import are generally understood by trading enterprises throughout the world and are governed by similar legal rules in virtually all countries.\(^{68}\)

The common criticism about the lack of predictability of the lex mercatoria can be rejected with Carbonneau’s remark that ‘a perusal of published maritime arbitral awards indicates that there is a high degree of substantive adjudicatory uniformity on major issues which typically arises in maritime litigation’.\(^{69}\) That is to say, there is a substantive predictability.

The second group of authors prefers to exclude the lex mercatoria mainly based on its failure to constitute an autonomous legal order, on its lack of authority, predictability and consistency. In this group, Flanagan holds that the lex mercatoria fails the prerequisites of an autonomous legal system and therefore is not a practical choice of law for international contract, but that it could survive as a collection of distinct legal principles and rules.\(^{70}\) The sceptics consider that, whatever content may be ascribed to the new law merchant, it is not the repository of ‘true’ legal rules or procedures that can protect parties against the abuse of discretion and unprincipled adjudicatory determinations.\(^{71}\) Mann expresses his sceptical view about the existence of the lex mercatoria in the following terms:

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\(^{68}\) Berman and Kaufman (n 35) 221.

\(^{69}\) T Carbonneau, ‘A Definition of and Perspective upon the Lex Mercatoria Debate’ in Carbonneau (n 42) 16.


\(^{71}\) F Mann, ‘Introduction’ in Carbonneau (n 42) xxiii; see also G Delaume, ‘The Myth of the Lex Mercatoria and State Contracts’ in Carbonneau (n 42).
One of the purposes of that doctrine is to eliminate the search for the proper law of the contract or, more generally, the rules of conflict of laws. More than that, the purpose is to substitute ill-defined ‘equity’ for rules of law, to rely on what is considered fair and conforming to usage. It is difficult to imagine a more dangerous, more undesirable and more ill-founded view which denies any measure of predictability and certainty and confers upon parties to an international commercial contract or their arbitrators, powers that no system of law permits and no court could exercise.\(^\text{72}\)

It is difficult to agree with the pessimistic position towards the existence of the lex mercatoria, for a number of reasons.

Firstly, effectively, a large part of the world trade is based on standard contract conditions issued by trade associations.\(^\text{73}\) To illustrate this with an actual example, in the award rendered the 13\(^{\text{th}}\) July 1998 the arbitrators found that:

> While it was acceptable for the buyer (claimant) to buy higher quality coffee for a coverage deal if there was a shortage of suitable coffee on the market, the buyer breached its obligations under the Hamburg coffee trade usages by failing to mitigate the damages and to inform the seller of its intention to re-sell the coffee to a third party, as the seller was unable [to] ‘influenc[e] the sale and the sale’s timing’ (bold added).\(^\text{74}\)

Secondly, international trade contracts usually provide for submission of any dispute to arbitration under the rules of a trade association or the ICC. As has been seen with the example of article 17 of the ICC Rules of Arbitration,\(^\text{75}\) the rules governing institutional arbitration consider general principles and customs of the trade to solve the controversy.\(^\text{76}\)


\(^{\text{74}}\) (2000) 25 Yb Comm. Arb’n 216. According to the award, the Hamburg coffee trade usages were applied in force of article 43 of the European Contract for Coffee (ECC).

\(^{\text{75}}\) See n 50 and accompanying text.

\(^{\text{76}}\) Cf. Berman & Kaufman (n 35) 228. Other norms providing for the application of the lex mercatoria are studied below in this sub-section.
Thirdly, ‘the adage Lex ubi voluit dixit, ubi noluit tacuit’\textsuperscript{77} has been recognized by the practitioners of law as false and dangerous in its generalization, and no interpreter would any longer base any proof whatsoever upon it alone.\textsuperscript{78} In the case of paucity of regulation, arbitrators apply the lex mercatoria. For example, article 42 of the ICSID Convention on the Settlement of Investment Disputes between States and Nationals of Other States expressly permits an arbitrator to apply the laws of the host state as well as rules of international law to a dispute where the parties have not made an express choice of law. Article 42(2) provides that ‘The Tribunal may not bring in a finding of non liquet on the ground of silence or obscurity of the law’. With regard to this norm, it has been said that ‘it is reasonable that in the non liquet situation the tribunal should look to lex mercatoria to fill gaps or clear up obscurity in the applicable law’.\textsuperscript{79}

Fourthly, it has long been recognized that there is a relationship between the legal method of a period and the type of thinking generally prevalent at that period. The lex mercatoria conforms to the way of thinking globally which prevails nowadays. The lex mercatoria is a consequence of the collapse of positivism,\textsuperscript{80} which insists on the separation of law and morals or, in other words, on the separation of law as it is and law as it ought to be. It is directly contrary to natural law theories, which tend to have some touchstone

\textsuperscript{77} ‘When the law wanted to regulate the matter, it did regulate the matter; when it did not want to regulate the matter, it remained silent’.
\textsuperscript{78} G Del Vecchio, \textit{General Principles of Law} (F Forte tr, Boston University Press, Boston 1956) 51.
\textsuperscript{79} Molineaux (n 24) 63. Here, in 1992 the Resolution on Transnational Rules adopted at the 65\textsuperscript{th} International Law Association Conference in Cairo stated that: ‘The fact that an international arbitrator has based an award on transnational rules rather than the law of a particular state should not in itself affect the validity of the award: 1) where the parties have agreed that the arbitrator may apply transnational rules; 2) where the parties have remained silent concerning the applicable law’. See A F M Maniruzzaman, ‘Conflict of Laws Issues in International Arbitration: Practice and Trends’ (1993) 9 Arb.Int'l 371.
\textsuperscript{80} Wieacker describes the stages of European legal thinking as follows: ‘The epochs in the history of German private law also match the four great shifts in European legal thinking, perhaps more marked in Germany where the intellectuals were more impressionable than in the old nation states of Europe. After the emergence of European legal science in the twelfth to fourteenth centuries they were: its diffusion (“reception”) throughout the whole of Europe between the thirteenth and sixteenth centuries, the rise and dominance of the modern law of nature in the seventeenth and eighteenth century, the historical school and positivism, both scientific and textual, in the nineteenth century, and finally the collapse of positivism and the legal crisis in our own century’. F Wieacker, \textit{A History of Private Law in Europe. With Particular Reference to Germany} (Clarendon Press, Oxford 1995) 7.
that a man-made law has to meet for its validity.\textsuperscript{81} The application of the lex mercatoria is a natural reaction to the necessity for a freer approach which aims to go beyond the positivist structures in the pursuance of justice in commerce. Lex mercatoria constitutes the corrective of strict legalism, as it has been necessary throughout ancient and European legal history: ‘In Rome with the discretionary powers of the praetor, in the Middle Ages the \textit{aequitas canonica} and in modern statutory positivism the general clauses and the judicial balancing of interest’.\textsuperscript{82}

Finally, on the practical side, in the European Court of Justice there is an opinion of the Advocate General acknowledging the existence of the lex mercatoria as regards a case discussed before the English Court of Appeal. The following passage is noteworthy:

\begin{quote}
The foregoing general outline, which should be supplemented by a description of the essential role of the permanent arbitration institutions or the emergence of a new lex mercatoria, gives a general picture of international arbitration which, having progressively fewer links with national legal systems, is tending, according to some commentators, to become ‘denationalised’ or indeed ‘delocalised’.\textsuperscript{83}
\end{quote}

In summary, certainty derives from authority and such authority does not exist in the context of the lex mercatoria. However, the truth derives from reason and this is most important for the quality of justice granted by the arbitrator to merchants coming from different cultures. It seems that the lex mercatoria is a reasonable system as it represents the shared legal understanding of the international merchant community.

\section*{1.1.1.4 SOURCES AND CONTENT}

Two theories mark the debate in this field:

- There is a broad theory that considers as components of the lex mercatoria all principles and rules governing specifically international

\textsuperscript{81} See H L A Hart, Positivism and the Separation of Law and Morals (1958) 71 Harv.L.Rev. 593.
\textsuperscript{82} F Wieacker, ‘Foundations of European Legal Culture’ (1990) 38 Am.J.Comp.L.1, 25.
contracts, be they enacted by interstate treaties or even state legislations or spontaneously produced by the *societas mercatorum*, following usages of international trade and general principles.

- The restrictive theory limits the content of the lex mercatoria to usages and general principles spontaneously produced in the ambit of international trade. Berthold Goldman is a leading exponent of this theory. The following is his definition of lex mercatoria: ‘A set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular system of law’.84

Goldman assumes a narrow vision of lex mercatoria by setting the features of its sources to be transnational, customary and spontaneous. At the same time, he does not believe that the laws of inter-state or state origin relating to international trade can immediately form part of the lex mercatoria, but that through a process of frequency of practice in international trade they become transformed into customary law. His writing on the clause *rebus sic stantibus*85 illustrates his definition of the lex mercatoria:

No doubt international arbitrators stick, in principle, to *pacta*, and one could contend that this has nothing to do with lex mercatoria, since this principle is embodied in practically all municipal legislations. It is to be noted, nevertheless, that very frequently, when they apply *pacta sunt servanda* arbitrators do not refer to a particular municipal legislation; they see the principle as a general one, which means that it is applied as an element of the lex mercatoria, and therefore, that its actual consequences are not to be taken from any municipal law whatsoever.86

85 During the Middle Ages the notion of clause *rebus sic stantibus* – or the implied condition that circumstances would not change and that the will of the parties was conditioned thereby – was developed. In a general way, the clause goes back to the writings of Baldus in the fourteenth century (*Commentaria* ad D.12.4.8). The doctrine remained popular until the nineteenth century when the parties’ intent became more sacrosanct. The key point in the case of change of circumstances is the allocation of the risk. For example, in Germany due to the inflation in the aftermath of the First World War the issue was how could one achieve an equitable distribution of the currency risks in a currency market which found itself in great turmoil. In practical terms, the change of circumstances implies the modification of the framework in which the formation of the contract took place. In international commercial contracts *force majeure* and hardship cover these situations of economic disequilibrium during the performance of the contract. See articles 7.1.7 and 6.2.2 of the UNIDROIT Principles of International Commercial Contracts.
86 Goldman (n 84) 125.
The same is the case of rules aimed to minimise damages. They come originally from the common law area, but they are enshrined in the lex mercatoria nowadays as rules with independent value.\(^{87}\)

Goldman’s view is accepted here, in light of the positions taken in arbitral awards recorded throughout this thesis: arbitrators apply what appears as customary rules accepted as binding by international traders. Furthermore, the existence of a substantive lex mercatoria – which is not necessary enshrined in positive rules – explains that sets of principles, such as PICC, are continually revised and updated. Here, consider the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit.\(^{88}\) This Convention regulates instruments which have long been used in international trade and finance for securing payment and performance in international commercial contracts.\(^{89}\) The international practice generated concepts and principles in this area which have been widely used and commonly accepted; therefore, they can be characterized as elements of the lex mercatoria.\(^{90}\) The Convention barely changes the existing self-regulation and it is hardly innovative.\(^{91}\) For that reason, the proper Convention has been characterized

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\(^{88}\) The Convention was adopted by the General Assembly of the United Nations on 11 December 1995 and entered into force on 1 January 2000.

\(^{89}\) The UNCITRAL’s website states that, ‘The Convention also solidifies recognition of common basic principles and characteristics shared by the independent guarantee and the stand-by letter of credit:


\(^{90}\) The following are the attempts of self-regulation by the international trading community in this area: 1) in 1978 the ICC published Uniform Rules for Contract Guarantees (UCG); 2) as a result of the revision of in 1983 of the Uniform Customs and Practice for Documentary Credits (UCP), it was decided to include stand-by letters of credit under the scope of UCP; 3) in 1992 the ICC published the Uniform Rules on Demand Guarantees (URDG); 4) in 1998 the US Council of International Banking (USCIB, now the International Services Association) embarked in a project to formulate self regulatory rules for the US stand-by letter of credit market. These International Stand-by Practices (ISP Project) led to International Stand-by Practices (ISP98) which were adopted by USCIB. See F De Ly, ‘The UN Convention on Independent Guarantees and Stand-by Letters of Credit’ (1999) 33 Int'l L 831. See also N Horn (ed), Legal Problems of Codes of Conduct for Multinational Enterprises (Kluwer, Antwerp & Boston 1980); N Horn, ‘Normative Problems of a New International Economic Problem’ (1982) JWTL 338; R Horn and C Schmitthoff (eds), The Transnational Law of International Commercial Transactions (Kluwer-Devanter, Antwerp & Boston 1982).

\(^{91}\) De Ly (n 90) 844 states that, ‘The Convention complements the existing self-regulation provided for in URDG, UCG, UCP, and ISP98’. 
as an expression of the lex mercatoria. In this case the arbitrator who applies the Convention applies elements of the lex mercatoria, which had existed as such before the Convention was enacted.

On the other hand, Schmitthoff has a positivist view of the lex mercatoria. He states that the lex mercatoria is developed in national contexts: ‘Transnational law is the uniform law developed by parallelism of action in the various national systems in an area of optional law in which the state in principle is disinterested’. The same author asserts: ‘The modern lex mercatoria is the deliberate creation of formulating agencies and is expressed in international conventions or model laws or in documents published by such bodies as the International Chamber of Commerce’. Consequently, commercial custom is not part of the ‘new’ law merchant, as he calls it. It is only the raw material which has to be distilled into formally enacted or declared rules in order to become binding.

The understanding of the lex mercatoria as ‘spontaneous law’ (i.e., Goldman’s narrow view) means that the lex mercatoria is generated outside governmental intervention by practitioners, due to the necessity to regulate areas uncovered or insufficiently governed by national laws. However, the insufficiency or non absolute autonomy of the lex mercatoria is also acknowledged. National and international law have an essential role in aspects uncovered by the lex, for example, the capacity of the parties.

In essence the lex mercatoria is made by contract practices and the common understanding on which they are based. Contract practices and usages of trade are truly spontaneous and subjected to modification or adaptation according to the necessities of traffic. The lex mercatoria may act

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93 There are also a number of authors, who agree with Goldman’s narrow view, inter alia, Roy Goode. See Goode (n 17) 2-3; and R Goode ‘The adaptation of English Law to International Commercial Arbitration’ (1992) 8 Arb.Int’l 1, 12-13. Similarly, Audit considers lex mercatoria as a body of ‘spontaneous’ law, i.e. law created by standard commercial practices and arbitral decisions. See B Audit ‘The Vienna Sales Convention and the Lex Mercatoria’ in Carbonneau (n 42).
95 Schmitthoff (n 35) 21.
96 See Maniruzzaman (n 57). See also Lowenfeld (n 58) 84-5.
as a source for international conventions, for the international private law and even for the contract law of each country, but it exists as such before it is embraced by these regulations. This does not mean that the principles of the lex mercatoria are always incorporated into conventions. In fact, several conventions do not reflect the lex mercatoria.

It is considered here that the work of formulating agencies is the formal face of the lex mercatoria. However, this formalization is not a *sine qua non* for its binding force. The lex mercatoria is a spontaneous force.

Formulating agencies and intergovernmental organizations – such as UNIDROIT – have made excellent compilations of important segments of the lex mercatoria. Besides, the process of harmonization of commercial laws in different regions of the world (Africa and America, for instance) is incorporating the lex mercatoria. Furthermore, at a global level, in 2000 UNCITRAL Secretary Gerold Herrmann proposed the preparation of a Global Commercial Code in the form of a compilation of special rules relating to the most important types of commercial transactions.

This reality prompts a new question: will the new lex mercatoria disappear, absorbed by the work of formulating agencies or by a universal code as it happened once with the old lex mercatoria?

A more or less universal consensus upon the general rules in commerce can be forecast. However, since the special needs of different sectors of trade in different regions can be answered on the grounds of

97 The bodies currently involved in the formulation of harmonized or unified legal regimes to regulate trade can be broadly grouped into governmental or public bodies and non-governmental or private bodies. Public bodies can be international, such as agencies of the United Nations (the United Nations Commission on International Trade Law – UNCITRAL – occupies a special position here), UNIDROIT (International Institute for the Unification of Private Law) and the Hague Conference on Private International Law. They can also be regional bodies such as the European Union, Association of South East Asian Nations (ASEAN) and the Commonwealth of Independent States. Private bodies include business groupings, such as the International Chamber of Commerce, trade associations and institutions formed by learned people, e.g. Lando Commission (see in regard to the latter: <http://webh01.ua.ac.be/storme/CECL.html> accessed 29 April 2011).

98 See Chapter Four, Sections 4.5 and 4.6.

practice, it is possible to assert that the lex mercatoria will continue to exist independently of the work of formulating agencies.

Lando – with a broad interpretation – provides a non-exhaustive list of elements of the lex mercatoria:\footnote{100} 100

1) Public international law;
2) Uniform laws for international trade (\textit{e.g.} CISG),\footnote{101} 101
3) General principles of law;
4) The rules of international organizations and projects to unify commercial laws, such as UNIDROIT and the Commission on European Contract Law;
5) Customs and usages of international trade,\footnote{102} 102
6) Standard form contracts;
7) Reporting of arbitral awards.

Evidently, it is difficult to nominate one by one all the elements of the lex mercatoria; this effort of synthesis made by Lando is, therefore, relevant. It must be added that it would be convenient to consider the practical element of the public policy of the country in which the enforcement of the award is likely to be requested.\footnote{103} 103 This is self-explanatory since an award based on the lex mercatoria but against the public policy of the country in which it must be enforced will remain, in the best of the cases, as an excellent disquisition on law.\footnote{104} 104 Besides, the first element of the list – public international law – generates concern, since, in theory, only the states are subject to international

\footnote{100} Lando (n 47) 751.

\footnote{101} According to the authors who favour the existence of the lex mercatoria, under CISG the lex mercatoria is the chief source of the applicable law for the international transactions, either directly as trade usages, or indirectly through the application of the principle of party autonomy in contract. The Convention itself, they maintain, purports to qualify as an expression of the lex mercatoria. \textit{Cf., inter alia}, J H Dalhuisen, \textit{Dalhuisen on Transnational and Comparative, Commercial, Financial and Trade Law} (3rd edn Hart Publishing, Oxford 2007) 404.

\footnote{102} In this category there are some ‘codified’ customs, for instance INCOTERMS, Uniform Customs and Practice for Documentary Credits (UCP) and the Force Majeure and Hardship Clauses issued by ICC in 2003.

\footnote{103} This is implicit in Lando’s contribution (n 47) and this is also the explicit position of Lord J Mustill in ‘The New Lex Mercatoria: The First Twenty-Five Years’ in M Bos and I Brownlie (eds), \textit{Liber Amicorum for the Rt. Hon. Lord Wilberforce} (Clarendon Press, Oxford 1987) 149.

\footnote{104} Art. 1502 n. 5 French Code of Civil Procedure states: ‘An appeal against the decision, which grants recognition or enforcement, will be available only in the following cases: 5° if the recognition or enforcement is contrary to public international order’. French law recognises the lex mercatoria as the basis of an award in article 1496 of this Code.
public law. Commercial relations, however, usually take place between private parties or between a private party and a state. Thus, in seeking to make sense of Lando’s position, the diverse roles of the state participating in arbitration are considered here.

The state can be part of a commercial arbitration process divested of its sovereign authority, acting in its private capacity (jure gestionis) when engaged in a contract with a private party. By contrast, investment treaty arbitration implies a state’s relation with foreign investors in which the former is acting in its function as sovereign authority (jure imperii). The concept of ‘internationalized’ contracts has been elaborated for these cases. Modern practice generally prefers an approach that denationalizes the applicable substantive law and applies general principles of law. Paradigmatic in this sense is the award rendered in 1963 in the Sapphire v National Iranian Oil Co. (NIOC) case. Under Article 38, para.1, of the Concession Agreement the parties undertook to carry out the provisions of the contract in accordance with the principles of good faith and good will. The sole arbitrator had several reasons for dismissing the application of a national law to the substance of the dispute – particularly that of Iran, which appeared in principle as the most suitable. First of all, the arbitrator stated that these concessions gave the contract a particular character, which lies partly in public law and partly in private law. Secondly, Iranian law was considered incapable of offering adequate guarantees for the Canadian company (Sapphire). Thirdly, the aforementioned clause contained in article 38 was considered as ‘scarcely compatible with the strict application of internal law of a particular country’. Consequently, the arbitrator applied the rules of law, based upon reason, which are common to civilized nations ‘such as are formulated in their statutes or are generally recognized in practice’.

In this context, another interesting case is Kuwait v AMINOIL (American Independent Oil Company).

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106 (1967) 35 ILR 136. See Chapter Five, n 18 and accompanying text.
107 Ibid 173.
108 Ibid 175
In 1948 Kuwait and AMINOIL concluded a concession agreement. In 1961 the parties entered into a Supplemental Agreement, which fundamentally contained in Article 9 a ‘renegotiation clause’.\textsuperscript{110}

In July 1973 an ‘Interim Agreement’ was made in order to incorporate a number of changes required by OPEC resolutions. This agreement was never signed by the government.

In November 1974, OPEC resolutions determined that some changes were necessary. However, negotiations failed and no agreement took place.

In September 1977 the government by decree-law n.124 terminated the agreement with AMINOIL.

In July 1979 the parties signed an arbitration agreement providing for an ad hoc arbitration in Paris. On 24 March 1982 the arbitral tribunal rendered an award of compensation for the nationalization by the state of Kuwait of the oil concession and local assets of AMINOIL.

The substantive law applicable to this case, according to the decision of the arbitral tribunal, was that of Kuwait and international law, understanding that the latter is part of the former. However, it is submitted here that it seems clear that the parties in their agreements retreated from applying the traditional sources – municipal and international law\textsuperscript{111} – but intended to apply a third source made up of customs and general principles of law, the lex mercatoria. This view relies on the following grounds:

- The will of the parties. The 1973 agreement contains the following provision:

  The parties base their relations with regard to the agreements between them on the principles of goodwill and good faith. Taking account of the different nationalities of the parties, the agreements between them shall be given effect, and must be

\textsuperscript{110} Renegotiation clauses provide for cases in which the economy of the contract evolves to put in risk the equilibrium between the parties. In international arbitration the interpretation of clauses of renegotiation is restrictive, i.e., the absence of such a clause allows presuming that the parties are against renegotiation. See, \textit{inter alia}, award n. 5953 of 1989 in (1990) 11 JDI 1056. Original in French. The case is also reported in Collection of ICC Arbitral Awards 1986-1990 (Kluwer Law International, The Hague) 437.

\textsuperscript{111} The TOPCO case (\textit{Texaco Overseas Petroleum Co. v the Government of the Libyan Arab Republic}) (1978) 17 ILM 1. is paradigmatic in the field of the principle of internationalization of the law applicable to contracts between a state and a public entity. The tribunal stated that contracts between states and private parties can be ‘internationalized’ in the sense of being subjected to public international law. Such a decision resulted from the jurisdictional immunity of states that prevents the arbitral tribunal from ruling the proceedings according to the law of another state. In addition, it is stated in the award that, ‘The parties also “intended from the outset to remove their differences from the jurisdictions of the local courts”’. 
interpreted and applied, in conformity with principles common to the laws of Kuwait and of the State of New York, United States of America, and in the absence of such common principles, then in conformity with the principles of law normally recognized by civilized states in general, including those which have been applied by international tribunal.

- The parties stated in the arbitration agreement that, ‘The law governing the substantive issues between the parties shall be determined by the tribunal, having regard to the quality of the parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world’.

- In addition, other concession agreements between Kuwait and foreign nations referred to general principles of law.

Therefore, it is considered in this case that the arbitral tribunal took a step back to apply what did appear to be the logical legal system in this context.\textsuperscript{112}

Here, Maniruzzaman reveals a trend to free the arbitrator, even in cases related to foreign investment agreements, in the search for the applicable law.\textsuperscript{113}

From the sources enumerated by Lando a variety of principles and rules has been derived. Among the several principles encompass by the lex mercatoria, there are the following suggested by Lord J Mustill:\textsuperscript{114}

1. A general principle that contracts should \textit{prima facie} be enforced according to their terms: \textit{Pacta sunt servanda};
2. \textit{Rebus sic stantibus} serves as an exception to the first general principle when performing the obligation would be too onerous to bear because of the changed conditions;
3. The first general principle may also be subject to the concept of \textit{abus de droit}, and to a rule that unfair and unconscionable contracts and clauses should not be enforced;

\textsuperscript{114} Lord J Mustill (n 103).
4. *Culpa in contrahendo*;\(^{115}\)
5. Good faith;
6. Bribes render a contract void or unenforceable;
7. A state entity cannot be permitted to evade the enforcement of its obligations by denying its own capacity to make a binding agreement to arbitrate;\(^{116}\)
8. The controlling interest of a group of companies is regarded as contracting on behalf of all members of the group, at least so far as concerns an agreement to arbitrate;\(^ {117}\)
9. If unforeseen difficulties intervene in the performance of a contract, the parties should negotiate in good faith to overcome them, even if the contract contains no revision clause;
10. ‘Gold clause’ agreements are valid and enforceable (by courts). Perhaps in some cases either a gold clause or a ‘hardship’ revision clause may be implied (parenthesis added);
11. One party is entitled to treat itself as discharged from its obligations if the other has committed a breach, but only if the breach is substantial;
12. No party can be allowed by its own act to bring about a non-performance of a condition precedent to its own obligation;
13. A tribunal is not bound by the characterization of the contract ascribed to it by the parties;
14. Damages for breach of contract are limited to the foreseeable consequences of the breach;
15. A party which has suffered a breach of contract must take reasonable steps to mitigate its loss;
16. Damages for non-delivery are calculated by reference to the market price of the goods and the price at which the buyer has purchased equivalent goods in replacement;

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\(^{117}\) See ICC award n. 2375 (1976) 103 JDI 973.
17. A party must act promptly to enforce its rights on pain of losing them by waiver;
18. A debtor may in certain circumstances set off his own cross-claims to extinguish or diminish his liability to the creditor;
19. Contracts should be construed according to the principle *ut res magis valeat quam pereat*;\(^{118}\)
20. Failure by one party to respond to a letter written to it by the other is regarded as evidence of assent to its terms.\(^{119}\)

Lord J Mustill maintains that, ‘This list, incomplete as it may be, seems rather a modest haul for twenty-five years of international arbitration’.\(^{120}\) However, Goldman asserts, ‘for the list he is suggesting encompasses and offers answers to a large number, if not to all, of the issues that are usually raised in disputes relating to international economic relations’.\(^{121}\)

It is remarkable that about half of the twenty principles cited by Lord J Mustill in his article were specifically linked to the overarching principle of good faith which appears as ‘the principle of the principles’.\(^{122}\) Surely, Mayer bore this in mind when he wrote, ‘Every equitable solution will be imposed in the name of good faith’.\(^{123}\) However, this is not the proper time to analyse good faith, as the next chapters are devoted to its study.

Whatever the theory on the lex mercatoria, it is understood that general principles of law and general usages of international trade are the main pillars of it.\(^{124}\)

Fundamental legal principles are likely to be at the heart of all civilized modern legal systems. Further to it, Article 38 of the Statute of the

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\(^{118}\) According to this principle the interpretation of clauses must be orientated to give them an effect rather than make them fail. This principle looks towards the utmost preservation of juridical engagements. It is also enshrined in restatements of principles, e.g. PECL, Art.5.101 and UNIDROIT Principles, Art 4.1.


\(^{120}\) Lord J Mustill (n 103) 177.


\(^{122}\) The following principles of the list are linked to good faith: 2, 3, 4, 6, 7, 9, 10, 11, 12 and 15.

\(^{123}\) Cfr. Mayer (n 53) 554.

International Court of Justice includes among the sources for adjudication by the Court the general principles of law recognized by civilized nations.

In domestic laws, especially of the codified variety, general principles are often hidden, but they come into their own again in the lex mercatoria. For instance, *pacta sunt servanda* is a general principle of law which is at the basis of national legislations as well as in international law.

Drobnig highlights the relevance of general principles in their role of filling the gaps existing within the various individual pieces of unified contract law. General principles of contract law may also serve directly as a source of law. This occurs when the parties agree upon them as governing their contract.

Dasser states that the process of *elaborating* general principles of contract law consists in a comparison of national systems of contract law. It is considered that the method for *tracing* general principles of law cannot be that of pure abstraction from particular norms until more comprehensive determinations are reached. The reason – as inspired by Del Vecchio – is the following: from general principles it is not possible to derive, by deduction, all particular norms of a legal system. The reason for this is that they have empirical and contingent elements. In the same way, from particular norms it is not possible to obtain adequate knowledge of such principles, which in their generality would overcome every particular application.

Del Vecchio bases these principles upon *ius naturae*, since ‘The idea of natural law truly is one of those ideas which accompany humanity in its developments’. He reinforces this thought with Vico’s opinion that ‘this

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126 For example, the Preamble of the UNIDROIT Principles of International Commercial Contracts states that they are not binding upon the parties or the states, unless ‘the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like’. To like effect, article 1:101 PECL.
127 See Dasser (n 46) 135.
128 G Del Vecchio, ‘Sui Principi Generali del Diritto’ (1921) 85 Archivio Giuridico 33.
civilized world certainly was made by man and, therefore, its principles must be found in our human mind’.  

Other important elements of the lex mercatoria are custom and usages of trade. 

It is considered that the essentiality of custom in the lex mercatoria derives from the fact that international commerce implies the interaction of traders, *i.e.*, lex mercatoria is not a summary of commercial concepts and institutions in various legal systems, but it is primarily made by the spontaneous, continuous and binding repetition of conduct in trade. 

It is all too easy to gather in one expression ‘custom and usages’. The question is whether they are interchangeable. The answer is that, in fact, in international commercial law those terms have been unified. Nonetheless, the terms ‘usage’ or ‘usages’ are those generally used and for those terms, experts understand a settled practice which has acquired normative force and thus is equated with custom. 

Usages receive a prominent treatment in the CISG. Article 9 gives greater weight to trade usages, regardless of whether the parties specifically

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131 On the nature of customary law in the Western law tradition from the eleventh century onwards, see: A Watson, *The Evolution of Law* (Blackwell, Oxford 1985) 43 ff. Contrary to the view held in this thesis, De Ly (n 20) 278: ‘Transnational usages are not a formal source of the lex mercatoria. Furthermore it seems that the lex mercatoria has hardly any rules on the status of usages’.


133 In national law the situation is different. English law, for example, distinguishes custom as being constant, voluntary, certain, consistent and reasonable. The rule nowadays is that it can be established by precedent. On the other hand, usages are factual patterns of behaviour that are generally followed, are quite certain and have been in existence for some time. Traditionally they have been held binding on the basis of the presumed intentions of the parties. Schmitthoff holds that standard contract may develop into custom by general constant use, *e.g.*, the Uniform Customs and Practice for Documentary Credits 1962. C Schmitthoff, ‘The Unification or Harmonisation of Law by Means of Standard Contracts and General Conditions’ *(1968)* 17 Int’l & Comp.L.Q., 551, 554.
designated an applicable law. Thus, the Convention grants to the usages the character of an implied term.\textsuperscript{134}

The requirement of the binding character of the usages is patent in all provisions that enshrine them and also in judicial and arbitral decisions,\textsuperscript{135} e.g. the aforementioned article 38 (1) b) of the Statute of International Court of Justice provides:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: international custom, as evidence of a general practice accepted as law.

There must be a conjunction of \textit{usus} and \textit{opinio iure atque necessitatis} or, in other words, what is generally regarded as necessary and binding, in order to set up a rule of customary law. This aspect is rightly expressed by Goode:

\begin{quote}
Perhaps the most satisfactory way of capturing the element of obligation without reference to law is to say that the usage relied on must be one which is considered by the relevant mercantile community to bear on the making, proof, interpretation, performance or enforcement of the parties' commercial engagements towards each other.\textsuperscript{136}
\end{quote}

Usages, as it is logically understood, diverge from one sector of trade to another. There are usages applicable to international sales of goods – they can be particularly related to a specific commodity like coffee or grain –, usages applicable to oil agreements and those peculiar for the construction

\textsuperscript{134} Article 9 (1) CISG provides that parties are bound by usages to which they have agreed and by any practices they have established between themselves. In the case of silence of the parties, article 9 (2) declares that parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned. See B Audit, ‘The Vienna Sales Convention and the Lex Mercatoria’ in Carbonneau (n 42) 193.

\textsuperscript{135} Among the numerous cases in national jurisprudence, see \textit{Libyan Arab Foreign Bank v Bankers Trust Co.} [1989] Q.B. 728. In international arbitration, see \textit{ad hoc} award of 29 of May 1979 in: (1982) 7 Yb Comm. Arb'n 81. This international case, involving two Dutch traders of an Indian commodity with destination to the United Kingdom, was solved exclusively under the consideration of the existence of determined trade usages.

\textsuperscript{136} Goode (n 17) 10.
industry, just to name some examples. This distinction is relevant in practice on the grounds of proof, ‘for the more general the asserted usage the greater its affinity with a general principle of law and the lower the burden of showing that it is generally known’.\(^\text{137}\) An example of a usage that acquired such a general character to become a general principle of law is the *rebus sic stantibus* principle.\(^\text{138}\)

As regards regional expressions of the lex mercatoria, Kilian Bälz writing on Islamic financial law – which has formulated general principles and standards whose claim to validity is not dependent on the support of any national legal order – raises the question in terms of regionalism versus universalism of the lex mercatoria.\(^\text{139}\)

The author holds that internationalization, not only increases harmonization and promotes standardization at a global level but also, generates a new pluralism in its own right, based on regional or cultural common ties.

It is submitted here that it is not correct to present the lex mercatoria in terms of opposition to non-national manifestations of commercial law in the regions. The lex mercatoria, as a spontaneous phenomenon, springs from the common sense and the practice of the business and legal communities, rather than from governmental intervention; therefore, it includes regional expressions. Islamic finance law would be an expression of the lex mercatoria in a particular area of commerce. Thus, if it would appear that the parties have not specified the particular rules of the lex mercatoria, for example the UNIDROIT Principles, the financial Islamic law would supply the solution.

1.1.1.5 APPLICABILITY

In practice, arbitrators sometimes apply a national law and, additionally, in order to corroborate their findings, they also refer to a particular norm of the

\(^{137}\) Ibid 12.

\(^{138}\) See n 85.

lex mercatoria. This denotes the level of approval that the lex mercatoria currently enjoys among traders, as it is considered by arbitrators in order to validate their decisions.

Legal experts insist unanimously on the difficulty of finding out reliable data about the applicability of the lex mercatoria. Based on limited data only, such as the publication of awards by the ICC, some authors have been able to form conclusions. Dalhuisen, for instance, holds, ‘The empirical evidence suggests that parties do not specifically apply the general principles of the lex mercatoria as proper law in their arbitration agreement or, if so, do it to supplement rather than displace national law.

Lord J Mustill offers a new argument that excuses the researcher from seeking the explicit mention of the lex mercatoria as the applicable law:

Whether an arbitrator who approaches the matter in this way feels it necessary to employ the lex mercatoria or some established technique of a national system, some of the implication of a term, or whether he does not rationalize what he is doing but simply goes ahead and does it, is unlikely to make any difference in all but small minority of cases.

Indeed, practitioners and arbitrators usually apply the lex mercatoria without taking into consideration that they are doing so. Lowenfeld, who is an experienced arbitrator, states: ‘I think in fact many arbitral decisions make use of this approach, often without fully articulating it, and without an express discussion about whether an international law merchant really exists.’

Lowenfeld does not explicitly support the lex mercatoria as an autonomous system of law but believes in the existence of an ‘international way’ or ‘international solution’ to solve some matters differing from national

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141 Cf. in www.unilex.info the following awards: ad hoc arbitration held in Helsinki at 28.01.1998 where the arbitrator based the decision on article 36 of the Nordic Contract Law and, in addition, referred to article 7.4.13 (2) of the UNIDROIT Principles. Another interesting case is the ICC arbitral award n. 8540 of 04.09.1996 where the UNIDROIT Principles were used to confirm the conclusion reached by applying the law of the State of New York.
142 Dalhuisen (n 101) 604.
143 Lord J Mustill (n 103) 182.
laws, such as: *force majeure*, the obligation to mitigate damages and dealing in good faith. Specifically, he states that:

The elements of good faith or fair dealing, as seen by the arbitrators, came not from the internal law of a given state, but from perceptions of the arbitrators about how merchants in international transactions generally do behave and expect each other to behave ... I see the denomination of lex mercatoria as an attempt, only partly successful, to give doctrinal support to what arbitrators actually do.  

What Lowenfeld missed in his analysis of 1985 is that nowadays good faith is one of those areas where there is more agreement than discord between national laws.  

Vogenauer adds data in the line of parties upholding the applicability of the lex mercatoria:

The empirical evidence shows that businesses hardly make use of the existing possibility to ‘opt into’ soft law instruments, such as the PICC and the PECL, if they subject their cross-border transactions to international commercial arbitrations. But this evidence also highlights that businesses are not averse to the idea of an optional instrument as such and would appreciate the possibility to choose a neutral contract law regime.

A concrete example that reflects this trend is the choice of law clause contained in the Channel Tunnel contract, one of the most important infrastructures of modern times. Clause 68 of this contract provides:

“[t]he construction, validity and performance of the contract shall in all respects be governed and interpreted in accordance with the principles common to both, English

145 Though, according to the author, in the majority of cases the result reached by legal systems does not radically change. Zimmermann and Whittaker edited a book where 30 cases concerning good faith were analysed by jurists and lawyers coming from different European jurisdictions. The results revealed that, despite quite different points of departure, there is convergence in the solutions offered by national laws. See R Zimmermann and S Whittaker (eds) *Good Faith in European Contract Law* (CUP, Cambridge 2000).

146 Lowenfeld (n 144) 184.

147 See Chapter Two.

and French law, and in the absence of such common principles by such general principles of international trade law as have been applied by national and international tribunals. Subject in all cases, with respect to the works to be respectively performed in the French and in the English part of site, to the respective French or English public policy provisions (emphasis added).¹⁴⁹

The lex mercatoria means an alternative, not only for national law but also, to the sound unification of laws by states. The dilemma that this phenomenon invariably faces is: the unification regional or universal? In the lex mercatoria the adoption of customs and rules has been determined by the necessities of trade; therefore, some of them will be of universal application, some others, regionally implemented. Lex mercatoria accepts the peculiarities of legal training and legal traditions. It will be seen in Chapter Four of this thesis that states, on purpose or not, recognize this advantage of the lex and, for that reason, they recall the UNIDROIT Principles as a model for their own unification of law process.¹⁵⁰

Furthermore, the applicability of the lex mercatoria by arbitrators is accepted by national procedural rules. For example, in previous years the prevailing view in England was that English arbitrators must apply English conflict of law rules to find the law applicable to the merits of the dispute, and that they could not apply any substantive law other than that of a fixed and recognisable system.¹⁵¹ Even in 1993 the lex mercatoria was not included in

¹⁵⁰ See the analysis of the Uniform Act on Contract by OHADA in Africa and the Inter-American Convention on the Law Applicable to International Contracts by CIDIP in Chapter Four, Sections 4.5 and 4.6.
¹⁵¹ Justice Megaw in Orion Cía Española de Seguros v Belfort Maatschappij [1962] 2 Lloyd's Rep. 257, held that arbitrators are bound, in general, to apply a fixed and recognisable system of law. When the same clause came before the Court of Appeal in Eagle Star Insurance Co. Ltd. v Yuval Insurance Co. Ltd. [1978] 1 Lloyd's Rep. 357, Lord Denning said of Justice Megaw's decision, at p. 361: 'He was of opinion that such a clause was invalid and should be given no effect. Despite its presence, the arbitrators were to decide in accordance with the ordinary rules of law. If the arbitrators did not do so, their award could be set aside by means of a case stated'. As regards this orthodox doctrine, C Clarkson and J Hill in The Conflict of Laws (3rd edn OUP, Oxford 2006) 254-5 states: 'At common law, it was assumed that English arbitrators were bound to apply the choice of law rules which were binding on the English courts. This rule was the consequence of the traditional English approach that awards could be reviewed by the courts on points of law, including choice of law issues'. Further to this last aspect, Czarnikow v Roth, Schmidt & Co. [1922] 2 KB 478 reads: 'Arbitrators must understand that parties before them have a right to take the opinion of the Court as to whether the arbitrators should be given the guidance of the Court in matters of law, and that
Dicey and Morris – one of the leading works on private international law in England – because it was not considered a fixed and recognisable system. However, the new Arbitration Act 1996 has changed English law on this point. As a premise to explain this Act, it is necessary to set forth article 28 (1) of the UN (UNCITRAL) Model Law on International Commercial Arbitration 1985 which provides:

The arbitral tribunal shall decide the dispute in accordance with the rules of law as are chosen by the parties.

The emphasised rules of law include the lex mercatoria; in other words, the parties may choose the lex mercatoria to govern their contract.

Section 46 of the English Arbitration Act 1996 provides:

(1) The arbitral tribunal shall decide the dispute
(a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or
(b) if the parties so agree, in accordance with such other considerations as are agreed between them or determined by the tribunal.

Section 46 (3) provides that: if or to the extent that there is no such choice or agreement, the tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

In the explanatory notes to the Act (July 1995) made by the Departmental Advisory Committee on Arbitration it was stated that the cited they must not attempt to stop the action of the Courts by interfering with or hindering such a right of parties'. As regards the choice of law rules binding on the English Courts, see the following cases: Shamil Bank of Bahrain EC v Beximco Pharmaceutical Ltd [2004] EWCA Civ 19, [2004] 1 WLR 1784; and Halpern v Halpern [2007] EWCA Civ 291, [2007] 3 WLR 849. See the explanation of the traditional approach of English Courts in: O Lando ‘The Lex Mercatoria in International Commercial Arbitration’ (1985) 34 ICLQ 747, 758-9; and R Coulson, ‘International Arbitration a World of Options’ in Arbitration under International Commercial Contracts (Oceana, New York 1982) 49.

section corresponds to Article 28 of the Model Law on International Commercial Arbitration.\(^{153}\)

The fourteenth edition of Dicey & Morris (year 2006) notes the changes made by the Arbitration Act 1996 stating:

In England, prior to the 1996 Act (emphasis added), it was axiomatic that an English arbitrator was bound to apply English law, including the English conflict of laws rules to decide the substance of any dispute, and many of the most important cases in the conflict of laws arose by way of appeal on matters of law from arbitral awards. The other consequence of this approach was that, just as in the English courts (emphasis added), an English arbitrator could only apply a national legal system, designated as applicable by the relevant choice of law rule. The tribunal could not apply non-national rules, still less decide the dispute ‘*ex aequo et bono*’ or as an ‘*amiable compositeur*’, on the basis of general principles of justice and fairness.\(^{154}\)

Pursuant to s.46 (1) (b), Dicey & Morris state:

This option allows the parties the freedom to apply a set or rules or principles which do not in themselves constitute a legal system. Such a choice may thus include a non-national set of legal principles (such as the 1994 UNIDROIT Principles of International Commercial Contracts) or, more broadly, general principles of commercial law or the *lex mercatoria*.\(^{155}\)

Additionally, there is recent evidence of jurisprudential recognition of the *lex mercatoria* in English law. The English courts have recognized that on the basis of the Arbitration Act 1996 Section 46(1) (b) the parties are allowed the freedom to apply the *lex mercatoria*. In *Musawi v RE International (UK) Ltd.*\(^{156}\) it was decided that section 46(1) (b) of the Arbitration Act had entitled the parties to require the arbitrator to apply to the subject matter of the dispute and its resolution the principles of Shia Sharia law. A paragraph in this judgement states:

\(^{153}\) Department of Trade and Industry, Consultative Paper on Arbitration Bill (July 1995), Section 1 and Section 2: Draft Clauses of an Arbitration Bill, 38.


\(^{155}\) Ibid para. 16-053.

\(^{156}\) [2008] 1 Lloyd’s Rep. (Ch) 326.
Section 46 (1) (b) allows the parties the freedom to apply a set of rules or principles which do not in themselves constitute a legal system. Such a choice may thus include a non-national set of legal principles (such as the 1994 UNIDROIT Principles of International Commercial Contracts) or, more broadly, general principles of commercial law or the lex mercatoria.\textsuperscript{157}

The lex mercatoria has been recognized by the European Convention on International Commercial Arbitration (Geneva 21 April 1961) which allows the parties to determine by agreement the law applicable to the substance of the dispute; consequently, national courts must enforce arbitral awards rendered in accordance with the lex mercatoria. In addition, this kind of award has not been set aside by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 June 1958.

The most notable of the major international arbitral rules sanctioning the lex mercatoria are the ICC Rules in which article 17 (1) provides that:

The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate.

To like effect: articles 14.2 and 22.3 of the London Court of International Arbitration (LCIA) Arbitration Rules.

These norms of the ICC and the LCIA allow the parties and arbitrators to apply whatever rules of law they consider appropriate. It is important to note that the arbitral tribunal is not required to choose the applicable ‘rules of law’ by reference to a rule of conflict. It may apply the rules of law that it considers appropriate. Furthermore, these norms allow the application of the lex mercatoria, as has been widely recognized.\textsuperscript{158}

\textsuperscript{157} Though, it must be said that issues concerning the arbitration agreement itself were governed by English law.

Particular attention must be paid to the reception of the lex mercatoria in France where a government decree of 12 May 1981 has added new provisions on international arbitration to the Code of Civil Procedure. According to article 1496 the arbitrator applies to the contract the rules of law which the parties have chosen and, when no choice has been made, those which he considers appropriate (celles qu’il estime appropriées). The expert also takes into account all customs in commercial activities.

Leading French authors state that the new provisions of Title V International Arbitration of the Code of Civil Procedure in France acknowledge, not only the principle of party autonomy in international trade but also, the existence and development of rules of law other than those contained within the narrow framework of a single national legal system.  

The Dutch Code of Civil Procedure of 1986 (Book Four: Arbitration, articles 1054 and 1065) considers the application of the lex mercatoria by arbitrators. In this case the reference to the lex mercatoria is without doubt on the grounds of the Explanatory Report that defines the lex mercatoria as generally accepted usages in international trade which are autonomous from national law. Furthermore, a second Report added that lex mercatoria encompasses transnational rules and principles of law.  

The Convention on the Law Applicable to Contractual Obligations (Rome 1980) does not permit the application of a law which is not a state one. In Europe the Convention was improved by the European Commission through the Regulation n. 593/2008 of the European Parliament and of the Council on the Law Applicable to Contractual Obligation (Rome I).  

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160 Cf. De Ly (n 20) 250. This modern trend of arbitration laws, which allows arbitrators to apply the lex mercatoria, is considered by Mistelis to have a positive impact on arbitration. He calls this option ‘Voie directe, backed by a lex arbitralis materialis’ in L Mistelis, ‘The UNIDROIT Principles applied as “Most Appropriate Rules of Law” in a Swedish Arbitral Award’ (2003) 8 Unif.L.Rev. 631, 634.  
161 This Regulation, which entered into force on 24 July 2008, converted the Rome Convention on the Law Applicable to Contractual Obligations into a Community instrument. See Nils Willem Vernooij in (2009) 15 Colum.J.Eur.L. Online 71. In regard to the notable improvement contained in article 4 of the Regulation, which specified the general and vague
However, national law remains the applicable law, i.e. the lex mercatoria cannot be chosen by the parties as the applicable law to their contract.\textsuperscript{162}

The situation is different in the Americas, where the lex mercatoria is particularly vigorous today. The Fifth Inter-American Specialized Conference on International Private Law of the Organization of American States (OAS) approved the Inter-American Convention on the Law Applicable to International Contracts (Mexico 1994).\textsuperscript{163} In this Convention, even if the law regulating international contracts is the law of a certain state, in two articles rules of international or non-national character have been mentioned. In other words, the supplementary role of the lex mercatoria is accepted. The norms are: article 9, which mentions amongst the criteria that judges have to take into account in order to determine the state law applicable, ‘the general principles of international commercial law recognized by international organizations’; and article 10, which provides:

In addition to the provisions in the foregoing articles, the guidelines, customs, and principles of international commercial law as well as commercial usage and practices generally accepted shall apply in order to discharge the requirements of justice and equity in the particular case.\textsuperscript{164}

\textsuperscript{162} ‘Rome’s rule’ of application of the law with which the contract was more closely connected, see the Guidance on the Law Applicable to Contractual Obligations on: <http://www.justice.gov.uk/publications/docs/guidance-law-contractual-obligations-romei.pdf> accessed 29 April 2011.

However, the proposal of the European Parliament and the Council on the Law Applicable to Contractual Obligations (Rome I) adopted in Brussels 15/12/2005 foresaw the possibility to include the UNIDROIT and the PECL as the applicable law: ‘To further boost the impact of the parties’ will, a key principle of the Convention, paragraph 2 authorises the parties to choose as the applicable law a non-State body of law. The form of words used would authorise the choice of the UNIDROIT principles, the Principles of European Contract Law or a possible future optional Community instrument, while excluding the lex mercatoria, which is not precise enough, or private codifications not adequately recognised by the international community’. Although this exclusion seems categorical, in practical terms this proposal accepted the lex mercatoria, since the UNIDROIT Principles and the PECL enshrine the essence of the lex mercatoria (See Chapter Four, Sections 4.2 and 4.3) <http://www.europarl.europa.eu/oeil/resume.jsp?id=5301232&eventId=922934&backToCaller=NO&language=en> accessed 16 February 2010.

\textsuperscript{163} See the content summary of the Convention in: (1994) 33 ILM 732.

\textsuperscript{164} See a further analysis in Chapter Four, Section 4.6.
1.1.1.6 PROCEDURAL LEX MERCATORIA

According to national and international regulations the pattern is that the parties have the right to fix procedural rules for the arbitration. If they fail to do it, the arbitrator has the power to decide the best way to conduct the process, taking account of the needs of the case and the expectations of the parties.

The aforementioned regulations enshrine what were once normal practices. All of them demonstrate certain level of globalization of arbitral procedure, e.g.: IBA Rules on Evidence, the UNCITRAL Arbitration Rules and other Institutional Arbitration Rules.¹⁶⁵

Undoubtedly, the globalization of procedural rules of international arbitration is a fertile field to explore.¹⁶⁶ However, as the present work has a substantive approach to the lex mercatoria, focusing on a particular principle – good faith –, this issue will not be further developed. Instead, under the present heading the role of the arbitrator in the development of the lex mercatoria is examined.¹⁶⁷

This outlook entails an important phenomenon that is taking place in international trading dispute resolution and which could be labelled as the ‘supremacy of the iurisdiczione over legislation in the global society’.¹⁶⁸ The global community of merchants confers on the arbitrator the power/duty to decide on the basis of what this society freely accepts as binding. Here, Cremades in an article ahead of its time states:

Arbitral decision making has introduced a new commercial ethic into the international business community. The constant flow of arbitration awards is nourishing a new

¹⁶⁶ See ALI/UNIDROIT Principles of Transnational Civil Procedure of May 2004. The proper text reads, ‘These Principles are standards for adjudication of transnational commercial disputes’. There are 31 principles prepared by academics with the aim to reconcile differences among national rules of civil procedure. The purpose of that work is to serve as a model for the reform or elaboration of national procedural codes and for application – by analogy – to commercial arbitration processes.
legal order that is born of, and particularly suited to, regulating world business...
Arbitration grants a true ‘opinio iuris’ to the practices regularly used in the business world (emphasis added).\(^{169}\)

The publication of arbitral awards constitutes an invaluable way to know the lex mercatoria. On the other hand, over the years there have been numerous attempts aimed to ‘formalize’ the lex mercatoria, e.g., the impressive list of rules called Transnational Law Digest and Bibliography (TLDB) which is compiled on a continuous basis by the Centre for Transnational Law (CENTRAL) at the University of Cologne, under the guidance of Klaus Peter Berger.\(^{170}\) Another example of standardization of the lex mercatoria is the UNIDROIT Principles of International Commercial Contracts. Dasser commenting on Berger’s work in CENTRAL makes a distinction between the principles and rules here compiled – retaining them as part of the lex mercatoria – and the UNIDROIT Principles, which, according to him, may not be regarded as a codification of the lex mercatoria, but just as a source of inspiration due to their basis in comparative law and common sense.\(^{171}\)

Nottage, taking into account this formalisation of the lex mercatoria, announces an imminent return to less structured norms applicable to international contracts.\(^{172}\)

Since the work of arbitrators studying the facts, coordinating rules and exploring the needs of the parties and expectations of the international community is at the basis of this dynamic view of the lex mercatoria,\(^{173}\) is it possible to deduce that the substance of rendered awards should have precedential value?

\(^{170}\) Available at <http://tldb.uni-koeln.de/> accessed 29 April 2011.
\(^{173}\) Lando (n 47) 752 points out that the arbitrator is acting in this role as a ‘social engineer’. 
There are different positions on the subject. Opponents of the lex mercatoria contend that the law-making process is exclusively a state political function and that arbitrators hired to solve a single case can never issue determinations that have the force of law or be sources of autonomous rules of law. Conversely, Carbonneau maintains that states have legitimised the procedure of arbitration, its autonomy and, by strengthening its results, enforce them; therefore the content of arbitral awards can have precedent value.174

Then there is the issue about the character of the arbitrator when applying lex mercatoria: is he always acting as amiable compositeur and deciding ex equo et bono in these cases? The answer of all supporters of the lex mercatoria is categorical: those terms are not implied. It is not possible to equate amiable composition and ex equo et bono with the lex mercatoria, because that would make the lex mercatoria and equity identical – but those terms are not interchangeable; ‘the lex mercatoria obliges the arbitrator to base his decision on the law merchant even when equity might lead him to another result’.175

Naturally, arbitrators acting as amiable compositeurs are allowed to apply the lex mercatoria. An illustration of this is the ICC award n. 3540 given on the 3 October 1980. An arbitral clause designated Geneva as the place of arbitration and stated the law of the Canton of Geneva as applicable to procedural matters. The arbitrators were to decide as amiable compositeurs. Of core significance to this purpose is that throughout the parties disagreed on the law applicable to the substance of the dispute. The defendant pleaded French law as the substantive law applicable. The claimant, however, submitting to the discretion of the arbitral tribunal, wished that Swiss law be applied. The arbitral tribunal considered that it had to decide this with reference to the rule of conflict which it deemed appropriate, according to article 13.3 of the ICC Rules. Hence, the arbitral tribunal, deciding as amiable compositeur, stated that it would examine what the applicable law was by analyzing the indications given to it and by finding inspiration in the general

174 Cf. Carbonneau (n 42) 12.
175 Lando (n 47) 754-5.
principles developed in this respect by the recent case law of arbitral tribunals, particularly those constituted under the auspices of the ICC.\textsuperscript{176}

\textbf{1.1.1.7 CONCLUSION}

The lex mercatoria does exist in modern times as a real alternative for the regulation of controversies related to commercial contracts. This assertion is made in light of the effective application by parties to an international contract and by arbitral tribunals (this last aspect will be explored further in Chapter Five); and also in light of its recognition by national and international rules.

The lex mercatoria must be articulated in connection with national laws, since there are fundamental aspects of contracts not included in the lex mercatoria, such as the capacity of the parties.\textsuperscript{177}

The lex mercatoria existed in Europe in the Medieval Age and in the Modern Era until it was included in national laws starting from the seventeenth century. The lex mercatoria of our day has prompted a new perspective of good faith, which is the subject of the chapters that follow.

As regards the future of the lex mercatoria some facts need to be stated as a premise. After the creation of states and the tenacious defence of their sovereignty, what prevails nowadays is the creation of zones of free trade and labour worldwide.\textsuperscript{178} It is stated here that the trend of internationalization of the economy seems very difficult to reverse. Therefore, since national regulations are not able to offer satisfactory answers to the challenges of international trade, the conclusion appears logical: the main instrument of innovation will continue being the contract – mainly the circulation of international models of contract – and what practitioners feel to be binding. The development of the lex mercatoria is unavoidable, although in its creeping mode, as has been evident in recent times.

\textsuperscript{176} (1982) 7 Yb Comm. Arb’n 124. Article 13.3 of the ICC Rules was modified in 1998 and replaced by the new article 17. See n 159 and accompanying text.
\textsuperscript{177} For example article 3.1 of the UNIDROIT Principles reads: Matters not covered. These Principles do not deal with invalidity arising from (a) lack of capacity; (b) immorality or illegality.
\textsuperscript{178} Even zones in current dispute for their sovereignty attempt to create this zone of liberty.
1.2 OBJECTIVES

Since there is no study explaining the meaning of good faith in the lex mercatoria, the inclusion of the principle in international conventions – such as CISG\(^{179}\) – and also the approval of initiatives containing it at international or regional level are hindered. The following is an example of this situation: on 1\(^{st}\) July 2010 the European Commission presented a Green Paper with policy options for progress towards a European Contract Law for consumers and businesses\(^{180}\) based on the Draft of the Common Frame of Reference (DCFR).\(^{181}\) As regards DCFR, the English position was that it involved too much discretion, and hence uncertainty, by the use of ‘an astonishing number of vague and ambiguous terms, concepts such as “reasonableness” and “good faith”’.\(^{182}\) It is submitted here that, if the lex mercatoria is to continue to prevail in the area of international transactions that has become aware of the particularity of its needs and the strength of its agents to produce adequate solutions, then at all costs good faith must be presented with clarity. This would be a useful means to enhance the harmonization of law as well.

This study seeks to examine the nexus between these two developments in international trade: the emergence of the lex mercatoria; the evolution of good faith as its essential principle. It analyses the meaning given to good faith by practitioners and arbitral tribunals in contracts governed by the lex mercatoria. It seeks to demonstrate the hypothesis that this concept is objective (there is no attempt to search for the intentions of the parties) and that it is related to the needs of commerce nowadays.

The argument is addressed through the study of the development of good faith in history and in particular national laws from the civil and common law areas in order to establish:

\(^{179}\) Good faith in CISG has been included in article 7 for the interpretation of the Convention but not for the interpretation of the contract. See Chapter Four, Section 4.1.

\(^{180}\) The consultation ran until 31 January 2011.

\(^{181}\) C Von Bar, E Clive and H Schulte-Nölke (eds), Principles, Definitions and Model Rules of European Private Law; Draft Common Frame of Reference (DCFR) (Sellier, Munich 2009). See the analysis of the DCFR in Chapter Four, Section 4.4.

a) If good faith is a static or flexible concept, *viz.* whether it has evolved in history;
b) Whether good faith is understood in a different way in national laws;
c) The points of contact between the extensive background of good faith in history and in national laws and the current meaning given to it in the lex mercatoria.

Therefore, instead of operational standards to qualify good faith in the lex mercatoria – which have been offered by, for instance, North American authors like Summers, Burton and others from the time good faith was incorporated into the UCC, as it is explained in Chapter Two Section 2.5.1 – the purpose of this thesis is rather to depict the current panorama of good faith in the lex mercatoria and to determine the reasons for the current meaning of good faith. The philosophical foundations of the concept of good faith will be dealt with also.  

The task is not free from difficulties. Good faith is a concept essentially difficult to define in immutable words simply because it represents the conceptions of ‘good’ and ‘fair’ in a determined culture and time. In national legal systems ruled by statutes and under the aegis of jurisprudence the term tends to assume a more or less established meaning or understanding. Undoubtedly, in the lex mercatoria such a meaning does exist; but it must be made explicit here due to the nature of this system made up of general principles and customs and applied by arbitral tribunals.

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183 See Chapter Three, Section 3.2.

184 ‘The requisite of good faith is not in all places stipulated by words yet always by the principles of natural justice it is imperative’. Lord Morris of Borth-y-Gest, ‘Natural Justice’, 1973 (26) CLP 1, 7.
1.3 IMPORTANCE AND JUSTIFICATION

Berger, one of the most renowned supporters of the lex mercatoria, states that, ‘In the eyes of many practitioners, the notion of transnational law is limited to such general and vague principles as “good faith” and “pacta sunt servanda” which lack any concrete and workable content’.\(^{185}\) Advocates of the lex mercatoria have made scholarly efforts to overcome this through restatements of principles and internet platforms.\(^{186}\) However, there is a research gap in this regard, as the meaning of good faith in the lex mercatoria (not only in particular representations of it or in national legal systems) is not a matter of current concern.

In competent circles there is now essential agreement on each of the following propositions:

- The emergence of customs and principles that are being applied to international contracts;\(^{187}\)
- The harmonization of law as a regional phenomenon, \textit{e.g.}: EU, Africa (OHADA), the Americas (CIDIP) and the Caribbean (OHADAC);
- Good faith is a principle present in national spheres\(^{188}\) and now in the aforementioned harmonized trade law.

It just happens, however, that no one has connected these spheres in order to find out the current meaning of good faith in international contracts governed by the lex mercatoria. The aim of this study is to fill that gap by conducting an historical-comparative analysis of the principle.

\(^{185}\) K P Berger, \textit{The Creeping Codification of the Lex Mercatoria} (Kluwer Law International, London 1999) 5. This criticism comes from those who mainly point out the lack of 'definitiveness' of the lex mercatoria, \textit{i.e.}, the fact that this has not been made in a set of rules directly applicable to resolve a dispute.

\(^{186}\) Berger, for example, provides a list of 72 principles. The list comprises the following sources: the reception of general principles of law; the codification of international trade law by 'formulating agencies'; the case law of international arbitral tribunals; the law-making forces of international model contract forms and general conditions of trade; and finally the analysis of comparative legal science. It is available in the internet platform called the Trans-Lex Principles <http://www.trans-lex.org/principles> accessed 30 April 2011.

\(^{187}\) The dissension is whether they constitute an independent system of law.

\(^{188}\) In civil law good faith is not only a classic theme – since it is the fulcrum of the legal system of obligations – but it is also increasing in importance: \textit{e.g.} recently a number of sections inspired by good faith have been incorporated into §242 of the German BGB. In common law – as it will be seen – it is also gaining ground.
1.4 RESEARCH QUESTIONS

QUESTION 1: Is there a system of law called lex mercatoria?

This question stresses the need to define the field where the main subject is developed. There is no agreement over the lex mercatoria’s existence and content. The debate about the existence of an autonomous set of rules that transcend national boundaries and is applied to international commerce by arbitrators seems infinite: is there a non-national lex mercatoria? Is it a law totally separated from the state? Is lex mercatoria a law beyond the state? The polemic and the hundreds of writings addressing the issue point, at the least, to the existence of a legal phenomenon based on international trading. Far from remaining impartial, a supportive view about the existence of the lex mercatoria is assumed here.

QUESTION 2: Does the lex mercatoria exist as an absolute separate phenomenon from national laws?

It has been suggested that the lex mercatoria is not absolutely independent of domestic legislation. Firstly, important aspects, such as the validity of contracts and enforceability, are not covered by it. Secondly, traders and arbitrators interact in both fields. This is one of the reasons – the subjective element – that prompted the hypothesis that there could be some influence of national legislations over the concept of good faith in transnational law. The possibility of a unified concept of good faith in national and in international spheres shall be also explored.

QUESTION 3: What is the meaning of good faith in the lex mercatoria?

This is the fundamental question of this project. The establishment of the understanding of good faith in the lex mercatoria is essential for the reliability of this transnational system of law. It will help parties to understand
the meaning and scope of the duty they undertake and by what standards their conduct will be judged. It will be useful for arbitrators as well. However, in order to answer this question, a number of concerns relating to the lex mercatoria and to the role of good faith in this context must be addressed.

QUESTION 4: Is there a unified understanding of good faith in the lex mercatoria?

The theory of good faith as a cooperative element that permeates the contract is proposed in this study. The fundamental thesis is this: the necessities of global trade, the intervention of arbitrators from different legal backgrounds and the development of the contract theory have influenced the meaning of good faith in the lex mercatoria. Practical evidence and theory are considered in the following three chapters in order to prove these arguments.

QUESTION 5: Is the current concept of good faith in the sense of cooperation a desirable outcome?

Good faith is a wide principle, present in many institutions in national legislations, as has been stated in Section 1.1 of this Introduction. In the international sphere several intergovernmental instruments and all restatements of principles enclosing the lex mercatoria contemplate good faith as an essential principle. Thus, the relevance given to good faith in today’s law seems to suggest the convenience of its embracement. The historical-comparative study will help establish the reasons for such an essential role.

With regard to its particular understanding as cooperation, in practice good faith is the rationale of a number of new forms of contracting, such as partnering, franchising, etc. Since good faith cooperation is attempting to move parties forward to the dedication of common goals, to the understanding and the sharing of culture in international trade, it would seem that it

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189 See Chapter Three.
190 See Chapter Two.
represents a positive outcome. The analysis of arbitral awards will provide evidence for this hypothesis. However, it will also be argued that prior versions of good faith were not wrong but that they merely reflected the needs of their times.

QUESTION 6: Is the concept likely to change over time?

It will be proposed that good faith cooperation responds to the needs of global commerce; therefore, the probability of a change of meaning is associated with a change in the way to trade internationally.

Is there any likelihood of a reduction or a radical change in the way of acting between traders from different nations?

At this moment the certain datum is that global commerce governed by transnational law is increasing and, therefore, cooperation between merchants is likely to be emphasized. However, since it is proposed here that the notion of good faith in the lex mercatoria is also influenced by national laws, it is imperative to examine the trend followed by these systems in order to foresee, at least in the near future, what concept of good faith will prevail in transnational law.  

1.5 STRUCTURE OF THE THESIS

The body of the thesis is divided into six chapters:

Chapter One is introductory and helps to understand the lineaments of this study. Furthermore, this chapter provides an analysis of the literature on the lex mercatoria – the field in which this thesis is developed.

Chapter Two is devoted to the study of the genesis of good faith as a legal concept from the historical perspective and to reveal how the principle works in civil and common law traditions.

191 See Chapter Two, Sections 2.3, 2.4 and 2.5.
Chapter Three turns to the specific analysis of good faith in the lex mercatoria. It introduces the theory of good faith interpreted as cooperation. It also sets out the theoretical foundations of good faith cooperation.

Chapter Four analyses the principle of good faith in international instruments representative of the lex mercatoria.

Chapter Five examines the stance of arbitrators concerning good faith as part of the lex mercatoria.

Chapter Six draws together the research answering the research questions proposed in the introduction and offering concluding remarks.

1.6 CONTRIBUTION TO KNOWLEDGE

For sixty years or so, the phenomenon of the ‘new lex mercatoria’ has been revived by scholarship and has proved a fertile ground of discussion in the literature. The principle of good faith has also been considered by myriads of studies in national legal systems and international instruments. However, the approach taken here is that the several points of view as regards good faith and the lex mercatoria need to be brought together in one coherent explanation in order to cover the totality of the principle. This thesis, by integrating national and transnational systems of law in the analysis and ranging over a variety of disciplines, *inter alia*, history, philosophy and political theories, offers a critical insight into the meaning given to good faith in the lex mercatoria from a practical point of view, in the face of emerging necessity for the parties’ contractual relationship. It also sheds light on the reasons for the current understanding. Hence, the principle is evaluated in its totality.
1.7 LITERATURE REVIEW

1.7.1 PREMISES

This literature review deals exclusively with the role of good faith within the lex mercatoria. It provides, from the perspective of scholarly contributions, a relatively general, synoptic overview of the subject of this thesis. This is a complex subject due to the long range of the principle of good faith and the debatable nature of the lex mercatoria. For this reason, some highly technical matters have been simplified at this stage. A further analysis is to be found in the pertinent chapters of this thesis. Hence this introductory synthesis of the literature is what experts call an ‘Integrated literature review’, it integrates contributions of scholars throughout the thesis – those cited in this review will be revisited and others not considered will be revealed during the thesis.

This study offers a theory about the meaning of good faith in the lex mercatoria, a theory which mixes historical and comparative elements. However, this theory is not presented here but the elements that led to its elaboration are. The authors who provided the materials to lay the foundations of this theory are considered here. Of course, their contributions do not exhaust the modern discourse on the lex mercatoria and on good faith. Thus, as stated, numerous other relevant scholars will be cited throughout the thesis.

What follows is an analysis of those works that have partially examined good faith in the lex mercatoria and in national laws. As expected, the discussion places the thesis in the context of the literature to show the need for this project; it also points the way forward for further research.

1.7.2 GOOD FAITH IN TRANSNATIONAL COMMERCE TODAY

Good faith is perceived in the lex mercatoria as a powerful tool to avoid rigid structures, allowing the arbitrator to adapt the contract according to the

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192 See a revision of the literature on the lex mercatoria in the Sub-section 1.1.1.
complex circumstances of the international trade. From a practical point of view, Carbonneau observes that,

ICC arbitrators consider the good faith obligation as part of international commercial usages. They apply it as a matter of law. The view that good faith is a central element of cohesion in the operation of international commerce is supported by the generality of international awards and the accompanying scholarly commentary.

Despite this recognition, there is no clarity in professional and academic circles about the entire meaning of good faith in the lex mercatoria. The studies only pursue the meaning of good faith in particular representations of the lex mercatoria and, therefore, they are limited to the specific instrument or set of principles where they are developed. This thesis fills this gap.

In addition, this thesis postulates the influence of civil and common law on the development of the concept of good faith in the lex mercatoria. In order to prove this, it undertakes an historical-comparative approach inspired by Wieacker’s outlook that the history of law and comparative law are inseparable disciplines: ‘Since European law emerges from the interaction between new and vital kinds of law and the traditions of an ancient culture, one must know something of the relevant laws of general history in order to comprehend the process’.

195 T Carbonneau, ‘A Definition of and Perspective upon the Lex Mercatoria Debate’ in Carbonneau (n 42) 17.
197 F Wieacker, A History of Private Law in Europe. With Particular Reference to Germany (n 80) 25; See also Wieacker, ‘The Importance of Roman Law for Western Civilization and Western Legal Thought’ (1981) 4 B.C.Int’l & Comp.L.Rev. 257. When the author speaks about European law, he refers to the European legal culture or, according to Wieacker, ‘more precisely, the Atlantic-European. It includes, first of all, the whole continent in the geographical sense: between the seas in the North and the Mediterranean, between the Atlantic and the Ural Mountains. It includes further the European settlements in North America, as well as large parts of Central and South America, Northern Asia (Siberia), Australia, New Zealand, and the far South of Africa’. Wieacker, ‘Foundations of European Legal Culture’ (n 82) 5.
There are several texts addressing the subject of good faith in national laws:

Among these is the book edited by Beatson and Friedmann *Good Faith and Fault in Contract Law*.\(^{198}\) It contains a number of contributions addressing the following issues: conditions for the creation of contractual obligations; contractual performance (good faith, control and adaptation); and remedies for non-performance. This wide spectrum of themes goes beyond the strict subject of good faith. Despite the fact that this book attempts an analysis of French law, German law and the law of the US, it is mainly focused on English law, as is clear from the book’s introduction. Besides, European rules are considered in order to assess their impact on English law. The authors’ target here is on private contracts with numerous national cases concerned with situations such as landlord and tenant, employer and employee and also consumer law. Accordingly, the commercial approach is absent. However, this thesis has been enhanced by the essays in this book in a number of ways.

The first of these is that, though it is outdated (for example, it does not consider the modification of the German Law of Obligations contained in the *Bürgerliches Gesetzbuch* BGB in 2002), the study of municipal legislations by the different authors has contributed to the realisation of the influence of national laws on the understanding of good faith in the lex mercatoria.

Secondly, this book has contributed to the elaboration of the theoretical background of this thesis, since it describes the reshaping of contract law in the modern period, especially in England where the inclusion of rules of exemption and unfair terms meant an increased control over the contractual regime – with the consequential limitation over the freedom of contract. The book also emphasizes the current phenomenon of the greater weight given to fairness in contract law. As regards this last aspect, it will be seen in this thesis that nowadays neither the Uniform Commercial Code in the US nor the Restatements of Principles embracing the lex mercatoria (such as, PICC and

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PECL) include the doctrine of consideration, which has been replaced, in fact, by the requirement of good faith.\footnote{199}{See J Gordley, An American Perspective on the Unidroit Principles (Centro di Studi e Ricerche di Diritto Comparato e Straniero, Roma 1996).}

A modern classic in this area of good faith in Europe is the book edited by Whittaker and Zimmermann.\footnote{200}{Zimmermann and Whittaker (n 145).} The main scope of this book is to offer the perspective of different European legislations – by the analysis of scholars from different European legal systems – over thirty hypothetical cases related to good faith. Such an approach allows the contours of the concept to be identified through practical cases. This book also contains a number of articles written by leading experts in Roman law, medieval law and in the law of the US, and these have been useful for this thesis. The introductory article by the editors depicts excellently the current change in perspective regarding the re-emergence of a European (as opposed to merely national) private law. The chapter also makes clear the difficulties in assessing a subject such as good faith and highlights its topical importance, since all member states of the European Union have implemented the Directive on Unfair Terms in Consumer Contracts.\footnote{201}{Directive on Unfair Terms in Consumer Contracts of 1993 (ECC 93/13, 5 April 1993).}

The need for good faith in commercial transactions is an assumption of this thesis. This assumption will be founded on the history of law (Roman law and medieval law)\footnote{202}{Cf., inter alia, L Garofalo (ed), Il Ruolo della Buona Fede Oggettiva nell’Esperienza Giuridica Storica e Contemporanea: Atti del Convegno Internazionale di Studi in Onore di Alberto Burdese (Cedam, Padova 2003); W Holdsworth, A History of English Law Vol. 5 (3rd edn Sweet & Maxwell, London 1945); A Lattes, Il Diritto Commerciale nella Legislazione Statutaria delle Città Italiane (U. Hoepli, Milano 1884); P Vinogradoff, Roman Law in Medieval Europe (2nd edn Clarendon Press, Oxford 1929).} and modern doctrine.\footnote{203}{R Goode in Commercial Law (3rd edn Penguin, London 2004) 1208, for example, states: ‘Commercial law is rooted in principles of good faith, the sanctity of the agreement, the recognition of trade usage as a source of contractual rights, and the maintenance of a fair balance between vested rights and the interests of third parties’. See Chapter Two n 244.} In addition, court cases\footnote{204}{See, for example, Socimer v Standard [2008] EWCA (Civ Div) 116 in Chapter Two n 264 and accompanying text.} and arbitral awards reviewed (mainly) in Charter Five reveal that parties to a
commercial contract embrace good faith and also that judges apply this principle. However, there is an extreme position that rejects good faith in commercial matters, because it views good faith as ‘repugnant’ to the classical model of contract as self-interested exchange. This opinion, also, has a moderate version that accepts good faith as an ‘exception’. Brownsword explains that, according to this perspective, the requirement of good faith is introduced by a number of prohibitions against bad faith; such prohibitions serve to restrain the otherwise generally permissible pursuit of economic self-interest in contract.

Other authors have also reflected on the extension of good faith in commercial law. An interesting, although arguable, view is that of Sims. She elaborated an original theory about good faith as a layered principle or a principle composed by 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 of the circle, the higher the standard of behaviour that will be expected from the parties. **Commercial contracts**, for example, are represented by a circle which is 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 (emphasis added).

Sims’s argument, according to which good faith in commercial contracts must be reduced to honesty, cannot be sustained. It is an oversimplification. Although it may seem that law in this area is not interventionist, the truth is that a high degree of behaviour in good faith is asked of the parties, in the sense of the positive duties they have to fulfil. Steyn’s position, in fact, incorporates elements from Sims and the view held here in this thesis:

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Good faith has a subjective requirement: the threshold requirement is that the party must act honestly. That is an unsurprising requirement and poses no difficulty for the English legal system. But good faith additionally sets an objective standard, viz., the observance of reasonable commercial standards of fair dealing in the conclusion and performance of the transaction concerned.209

In support of the view here proposed, Brownsword states:

We should be careful, therefore, not to misconstrue Summers’s somewhat incautious remark that ‘a requirement of good faith is a minimal standard rather than a high ideal’. In practice, in certain commercial communities, even with good faith as an exception, a high degree of co-operation in contracting might be required.210

This statement is upheld in this thesis by the evidence found in the jurisprudence of English courts.211

1.7.3 A BOOK ON GOOD FAITH AND THE LEX MERCATORIA

A book called ‘Bona Fides und Lex Mercatoria212 mainly explores the lex mercatoria in the European legal tradition, firstly, from an historical point of view and, afterwards, during the era of nationalization of laws. Bona fides in the modern lex mercatoria is also part of this book. However, despite the title, it is not central to Meyer’s book.213 Furthermore, it does not consider the effect of national laws on the meaning of good faith in the lex mercatoria; likewise, arbitral awards are not considered in order to test pronouncements on this ambit; and sets of principles and international conventions are absent in the analysis. His book has a Europe-centric approach and, certainly, does not reflect upon manifestations of the lex mercatoria outside this ambit. This

210 Brownsword (n 206) 213.
213 Unfortunately, this book is confined to those who are able to read German. By contrast, this thesis, written in English, has the advantage of bringing ideas to a wider audience. See D Crystal, English as a Global Language (2nd edn CUP, Cambridge 2003).
thesis, on the other hand, considers manifestations of the lex mercatoria in the Americas, Africa and the Caribbean.\textsuperscript{214} However, there are points of coincidence between this book and this study, viz., the author's position that it is not too hard to prove the importance of good faith in the development of commercial law: he says that, ‘it is a perennial element’.\textsuperscript{215} A point of fundamental difference between this book and this thesis is Meyer's position that ‘A complete and definitive judgement on good faith in the 20\textsuperscript{th} century’s commercial law is still not possible’.\textsuperscript{216} Sixteen years later, such a statement has been completely overtaken. This thesis means to offer an explanation and judgement on good faith in the modern transnational commercial law.

1.7.4 A REVISED NOTION OF LIBERTY OF CONTRACT

Apart from history and municipal laws, there are a number of sociological and political theories which have influenced the concept of good faith in transnational trade law. Among those are: the ending of the nineteenth century’s theory of individualism; the consequential limitations imposed upon the freedom of contract; and the current cooperation between international traders.\textsuperscript{217} Atiyah in \textit{The Rise and Fall of Freedom of Contracts} and in ‘Freedom of Contract and the New Right’ describes the beginning of the ideology of freedom of contract in the nineteenth century and its decline in the twentieth century.\textsuperscript{218} However, in the nineteen eighties freedom of contract seemed to have been re-established, at least, as the ideology of the common law.\textsuperscript{219} Nonetheless, during the same period the rules from the European Union started to exert influence upon national legislations in order to embrace good faith.

The question is, therefore: is there a contradiction between freedom of contract and good faith? Strictly speaking there is no contradiction between

\textsuperscript{214} See Chapter Four, Sections 4.5 and 4.6
\textsuperscript{215} Meyer (n 212) 81.
\textsuperscript{216} Meyer (n 212) 76.
\textsuperscript{217} This thesis contains original reflections on cooperation in international trade.
\textsuperscript{219} Atiyah, \textit{Freedom of Contract and the New Right} (n 218) 15.
those terms, because, as Atiyah recognizes, ‘It is impossible to ignore the idea of a fair exchange in contract law’.\textsuperscript{220} As stated before, this assumption is at the heart of this thesis. Most importantly, it stresses the fact that nowadays good faith is not seen as a restriction to freedom of contracts but as a result of a partnering approach in contracts.\textsuperscript{221} This feature is highlighted by Zimmermann who calls this the ‘Rematerialization of contract law’;\textsuperscript{222} to signify a renewed infusion into law of ethical imperatives. Collins is equally aware of this phenomenon: in his book, \textit{The Law of Contract}, he considers that: ‘the concern about unjustifiable domination, the equivalence of the exchange, and the need to ensure co-operation … form the core of the interpretation of law of contract presented in this book’.\textsuperscript{223} Furthermore, there is evidence in the awards reported in this thesis about the effectiveness of this notion in the reality of international trade. For that reason, this theory defines the context of the present research and, ultimately, determines the answer of the main research question – the meaning of good faith in the lex mercatoria.\textsuperscript{224}

\textsuperscript{220} Ibid 11.
\textsuperscript{221} See Atiyah, \textit{The Rise and Fall} (n 218) 724; see Chapter Three, Section 3.2.
\textsuperscript{224} See Section 1.4 of this Introduction and Chapter Six.
2.1 INTRODUCTION

2.1.1 PREMISES

It was suggested in Chapter One (Section 1.1.1) that the lex mercatoria arose as an alternative to international private law for the regulation of international contracts. Arbitral courts now are increasingly confronted with various types of problems which can be dealt with more efficiently by invoking the lex mercatoria and aided by national laws – in those matters not regulated by the lex mercatoria.

The insufficiency of the lex mercatoria requires national laws to regulate certain areas. This has allowed the contact between both these systems and hence the transposition of their institutions. While the verification of this theory requires further research, the fact that practitioners who apply the lex mercatoria are acquainted with domestic regulations lends some instant credibility to it. Thus, these elements determine that this thesis on the meaning of good faith within the lex mercatoria should not disregard the national element. Yet, it was imperative to be selective about which national systems to consider.

The following are the reasons for selecting particular jurisdictions of the civil and common law area. This thesis is mainly concerned with Western law traditions. France and Germany are generally used as the archetypical civil law jurisdictions and English Law as the main common law comparator.1 These different traditions also represent different approaches to good faith. This thesis also examines the law of the United States which, being part of the common law area, has incorporated good faith in commercial contracts.

The methodology used in the analysis of national laws is the systematic comparison proposed by Kamba.2 It consists of three phases: descriptive, identification and explanatory phases. The first takes the form of a description

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1 P De Cruz, Comparative Law in a Changing World (Routledge-Cavendish, London 2007).
of the norms, concepts and institutions of the systems concerned. The second stage is concerned with the discernment of differences and similarities between the systems under comparative analysis. In the explanatory phase the resemblances and divergences are satisfactorily accounted for. Here, these phases are combined in the same discussion and are not dealt with as watertight compartments.

However, for reasons which will be made explicit soon, the study of national laws was not sufficient. The evidence found during the preliminary research for this project suggested the need to investigate good faith in comparative legal history. This outlook helps discover the causes which underlie the origin, development and the present state of the concept of good faith in the lex mercatoria.  

2.1.2 OBJECTIVES

The previous sub-section delineates the aim of this chapter yet the following are more precise objectives – which show the link between this chapter and the following ones:

- To establish the history of good faith. This knowledge is required in order to understand why good faith is such an essential principle and the reason for the meaning given to it in the new lex mercatoria. The historical dimension of good faith allows the thesis, not only to put in context the present situation but also, to predict future developments of the principle in the ambit of transnational law.

- To determine how good faith is understood in civil and common law traditions and whether these traditions have different views of the concept.

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3 Lambert at the First International Congress of Comparative Law held in Paris in 1900 considered that comparative law had two purposes: 'One is purely scientific, namely the discovery by means of a process of comparison of the causes which underlie the origin, development and extinction of legal institutions or, in other words, comparative legal history ...The second domain of comparative law, i.e. comparative legislation, has, according to Lambert, a practical aim and is not a science but a form of legal technique'. H C Gutteridge, Comparative Law. An Introduction to the Comparative Method of Legal Study & Research (CUP, Cambridge 1946) 5-6.
nowadays. This discussion is essential to demonstrate the theory that good faith in the lex mercatoria is a juridical concept influenced by national laws.

### 2.1.3 RELEVANCE

The relevance of this chapter is twofold: theoretical and practical.

In this thesis it will be demonstrated that the *societas mercatorum* spontaneously understands and applies good faith as cooperation for the common good of everyone involved in the contract or affected by it. This is far from the moral concept of good faith in canon law, but closer to the utilitarian aim that prompted the inclusion of good faith into Roman law – in the *ius gentium* and in the *bonae fidei iudicia* – as will be seen in this chapter. Therefore, from a theoretical point of view, it is important to determine why good faith has been embraced in such a utilitarian way in some periods, whereas in others it has been the epitome of a set of values that the law has attempted to attain.

*Prima facie*, it is possible to state that the structural role of good faith in all the periods of the law is explained by its connection with one of the guiding themes of all European legal and political philosophies – the dialogue between the theories of freedom and responsibility.\(^5\) At the basis of the contractual theory there is the individual and his freedom; integral to this premise is his responsibility towards the other party. Good faith stems from this tension because it is always in relation to another party. The following idea by Rodotà helps to understand how good faith concretizes responsibility towards that other: ‘If we want to turn to the old definition of contract by Durkheim as a “provisional truce between the parties” we can say that good faith is the rule of the rules of that truce. It is that that defines how this truce must be governed’.\(^6\) This judgement emphasizes the vital topicality of good faith.

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\(^4\) *Societas mercatorum* or the international community of merchants


faith nowadays where both contractual liberty and also responsibility are prominent in international contracts.\(^7\)

However, good faith has constantly generated concern because of the paternalism that it could entail by imposing moral criteria in commercial areas where the most liberal determination of the parties should prevail. In England, for example, at the end of the eighteenth century economic liberalism blocked Lord Mansfield’s intent to apply good faith as a general rule to contracts.\(^8\)

Paradoxically, today the common law of the United States, whose economy is largely based on liberalism, has welcomed the principle of good faith. It is also embraced in the lex mercatoria in a world of international transactions characterised by liberalism. The logical question is what is happening? Does the general clause of good faith improve the economic efficiency in contract law or does it represent a deterrent for traders? Do traders need good faith in their contractual relationship? From a practical point of view, it is essential to clarify this before having recourse to good faith in contracts through reference to a national or non-national system that recognises it.

### 2.1.4 METHOD AND STRUCTURE

The current notion of good faith in the lex mercatoria is closer to the utilitarian version of good faith that emerged in the ‘universal context’\(^9\) ruled by the Roman law.\(^10\)

This period and the following developments of the principle in the Middle Ages and during the Modern Age are analysed based on the

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\(^7\) Further to the argument of contract law as prompting the fulfilment of obligations, see the analysis on Holmes’ risk allocation theory in Chapter Four, n 29 and accompanying text.


\(^9\) ‘Universal’ is considered here in the sense of ‘pertaining to the Roman world’. Cfr. Cic.Off. 3, 17, 69; Gai 1,1. It is worth mentioning that Roman law was applicable to Roman citizens and also to foreigners or peregrini.

\(^10\) It is important to make clear that, despite the thoroughness given to this historical account, it is not a comprehensive study of the issue. Previous studies on good faith in Roman law and the aim of this thesis release this project from undertaking such a task. See an excellent literature review on good faith in Roman law in: L Fascione, ‘Cenni Bibliografici sulla Bona Fides’ in Studi sulla Buona Fede (Giuffrè, Milano 1975). Nonetheless, time is taken to explain some ideas that would need no explanation in a work intended for a specialised audience in Roman law; many citations and some textual passages are included in the footnotes, primarily for those who want to pursue matters further.
information obtained from scholarly writings of all ages and primary sources, such as the Corpus Iuris Civilis and European codes.

Regarding the second part of this chapter devoted to good faith in four Western law traditions, as it is the common method of comparative law scholars, the ‘important’ cases decided by appellate courts of foreign nations and the writings of their most important scholars will be examined. International arbitral awards based on these municipal systems will also be considered.

The content of this chapter is organized under the following headings:
- Good faith in history;
- Good faith in civil and common law (an overview);
- Good faith in civil law; and
- Good faith in common law.

2.2 GOOD FAITH IN HISTORY

2.2.1 BONA FIDES IN ROMAN LAW

The administration of justice in Rome in the field of private law was undertaken during the classic period by a unique institution, the Praetor. This magistrate supervised the decision-making of private judges (iudices privati), giving them the authority to collect evidence and to decide the case in accordance with his instructions (formulae). At the beginning of the praetor’s year of office, he informed the public of his intentions and procedural programmes by an edict.¹¹

At the outset of the formulary process (third century BC) the formula was based on the ius civile. However, the concept of good faith in iudicia stricti iuris, that is, in those claims to be decided according to the ius civile became important as a consequence of a standard clause inserted at the request of the defendant into the procedural formula. This clause was known

¹¹ For a brief résumé and, at the same time, rich account on the officium of the praetor and the relevance of the legal experts around him, the iurisconsultus, see: F Wieacker, ‘The Importance of Roman Law for Western Civilization and Western Legal Thought’ (1981) 4 B.C.Int’l & Comp.L.Rev. 257; and R W Lee, The Elements of Roman Law with a Translation of the Institutes of Justinian (4th edn Sweet & Maxwell, London1956)10.
as the *exceptio doli*. This clause provided the judge the opportunity to assess and to decide the case in accordance with what appeared to be fair and reasonable. This meant an evolution from the previous situation where if the claim lay outside the *ius civile* then it could not be enforced. It is not known at what point the edict began to contain actions based, not on the old civil *opertere* but rather, on the *opertere ex fide bona*.

_Ius civile_ in ancient Rome was the law for Roman citizens. When _cives Romani_ started to increase relations with other communities – Latin communities at the beginning and Italian and Mediterranean afterwards – it was necessary to recognize trade agreements between Romans and members of these communities. That is now considered a decisive factor in the origin and development of the _ius gentium_. Agreements and conventions in the _ius gentium_ produced a binding relation between the parties based on _fides_, on the commercial ethic and customs of the trade.

Thus, _bona fides_ in the _ius 12_  

S Whittaker and R Zimmermann, ‘Good Faith in European Contract Law: Surveying the Legal Landscape’ in R Zimmermann and S Whittaker (eds), _Good Faith in European Contract Law_ (CUP, Cambridge 2000) 16, state: ‘The _exceptio doli_ was worded in the alternative: ‘*si in ea re nihil dolo male AA factum sit neque fiat*’ (if in this matter nothing has been done, or is being done, in bad faith by the plaintiff). It was particularly the second alternative (*neque fiat* – or is being done) that made the _exceptio doli_ such a powerful instrument in bringing about a just solution, for it invited an answer which located _dolus_ not so much in personal misconduct, but rather in an inequity or injustice that would flow from the action being allowed to succeed’.

AA stands for Aulus Agerius and always refers to the plaintiff in the _formula_.

_See the developments of the _exceptio doli generalis_ in German Law in: R Zimmermann, _Roman Law, Contemporary Law, European Law. The Civilian Tradition Today_ (OUP, Oxford 2001) 83._

_Oporex et fide bona_ means what is necessary according to good faith.

_Further to the Praetor Peregrine, see F Serrao, _La Iurisdicció del Pretore Peregrino_. (Giuffrè, Milano 1954)._  

_Cfr. G Lombardi, _Ricerche in Tema di “ius Gentium”_ (Giuffrè, Milano 1946)._  

The following is the meaning that modern doctrine, making reference to Roman sources, attribute to the expression _ius gentium:_

_a) _A complex of norms and institutes related to the relations between _peregrini_ and Roman _cives_ and between _peregrini_ from different countries in Rome. This complex of norms would afterwards regulate also the relationships between Roman citizens. Some modern authors, stressing the way by which great part of these norms and institutes have obtained explicit acknowledgement in Rome, maintain that the _ius gentium_ is that created in Rome by the peregrine praetor, from the third century B. C. Almost everyone stresses how in this concept of _ius gentium_ norms and institutes of a limited field of law are enshrined, that is, the mercantile law._

_b) _It is a complex of norms and institutes common to all peoples. The basis of such community is the _naturalis ratio_ existent in those norms and institutes._

_c) _Complex of norms and institutes related to the relations between states. In modern terms it would be called International Public Law._
gentium presupposed, not simply a just conduct but also, the respect of the mercantile customs, according to the standard of that age.\textsuperscript{17}

The role of fides in Roman law was particularly important since it suppressed the ongoing tension between ius strictum and ius aequum.\textsuperscript{18} Here, Wieacker states that the praetor ‘set up new ethical standards in bonae fidei iudicia. Similarly, the praetor adapted the sluggish law of an agrarian tribal society to the new needs of commerce’.\textsuperscript{19}

In the praetor’s formula the judge received the instruction to require the defendant, in the case where the plaintiff proved the default of a contractual obligation, to do everything the former has to give or do according to good faith.\textsuperscript{20} Those terms allowed the judge some grounds of freedom to determine the amount of compensation.

The big question hitherto is how the magistrate determined what the parties had to do to perform according to good faith. There were no general indications, but particular solutions and, since the principle could not find an a priori determination, the judicial way was essential for translating the concept into applicable law. This means that judges grounded the concept of good faith according to each particular situation before them.\textsuperscript{21}

In spite of the closeness between good faith and the formulary procedure, fides cannot be reduced to the procedural aspect. Fides was a

\textsuperscript{17} F Wieacker, El Principio General de la Buena Fe (Original title: Zur rechtstheoretische Präzisierung des §242 BGB, Editorial Civitas, Madrid 1982).

\textsuperscript{18} *Ius praetorium est, quod praetores introduxerunt adiuvandi vel supplendi vel corrigendi iuris civilis gratia propter utilitatem publica* (The pretorian law is what the pretors introduced helping, supplying or correcting the civil law for the public good) Pap. D. 1, 1, 7, 1.

\textsuperscript{19} F Wieacker, The Importance of Roman Law (n 11) 266. Schulz in Classical Roman Law (Clarendon Press, Oxford 1954) 35 explains that, ‘The original meaning of a bonae fidei iudicium was as follows: the judge shall decide what as a matter of good faith (not ex iure quiritum) was due from the defendant to the plaintiff. In the time at which, for example, the formula venditi was created a formless contract of sale was not yet recognised by ius civile. Thus an actio venditi could not be founded on ius civile but only on good faith’. The praetorian origin of the iudicia bonae fidei has not achieved a consensus. A minority of the scholars maintains that iudicia bonae fidei had their origin in the ius civile and, consequently, that the imperium of the praetor had nothing to do with their creation. In other words, the praetor just shaped something pre-existent in the civil community. Cfr. as regards this topic, J Paricio, Rivista di Diritto Romano, Atti del Convegno Processo Civile e Processo Penale nell’Esperienza Giuridica del Mondo Antico; <http://www.ledonline.it/rivistadirittoromano/attipontignano.html> accessed 14 May 2011. Cfr. also A Carcaterra, Intorno ai Bonae Fidei Iudicia (Jovene, Napoli 1964) 144.

\textsuperscript{20} The formula was: *quidquid dare facere oportet ex fide bona*.

central idea in the legal and political thinking in Rome. \textsuperscript{22} \textit{Fides} precedes \textit{bona fides}. There was, however, a link between these two concepts. \textsuperscript{23} \textit{Fides} was understood as remaining faithful to one’s word; whereas \textit{bona fides} was applied to ascertain the implied content of contracts concluded. In this period the ethical character of good faith in the process was also important, since the \textit{bonae fidei iudicia} were used predominantly to impose sanctions on fraudulent behaviour. \textsuperscript{24} However, \textit{fides} (as a remote source of obligations) presented a remarkable practical character, since it was adopted in the \textit{ius gentium} to base contractual relations between traders. This last feature of the principle has persevered in international contexts throughout the ages.

\textbf{2.2.1.1 SUMMARY}

Good faith in Roman law was characterised by a utilitarian character, as \textit{bona fides} was invoked in the formula, not as a source of obligation but, in order to enlarge the discretion of the judge in arriving at his judgement. \textsuperscript{25} This practicality is a common feature with good faith in the modern lex mercatoria, as will be seen.

The concept of good faith in the Roman procedure was made concrete through the activity of the \textit{iurisconsultus}, the professional Roman jurist who assisted the praetor in the creation of the \textit{formula}. This expert was able to abstract the essence of each case and to specify the essential legal problem as a \textit{questio iuris}. In such a way, \textit{bona fides} was one of the most fruitful agents in the development of contract law. Good faith in the new lex mercatoria is also shaped by the international arbitrator.

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\textsuperscript{22} Cfr. A D’Ors, \textit{Derecho Privado Romano} (Ediciones Universidad de Navarra, Pamplona 1968) 30.
\textsuperscript{23} Further to the historical and conceptual link between the archaic notion of \textit{fides} and the clause \textit{ex fide bona} see: L Lombardi, \textit{Dalla “Fides” alla “Bona Fides”} (Giuffrè, Milano 1961).
\textsuperscript{24} Cfr. M J Schermaier, ‘Bona Fides in Roman Contract Law’ in Zimmermann and Whittaker (n 12).
\textsuperscript{25} For Wieacker the invention of the \textit{bonae fidei iudicium} was essentially a procedural reform. Wieacker, ‘Zum Ursprung der Bonaes Fidei Iudicium’ (1963) 80 ZSS 1. Cf C C Turpin, ‘Bonae Fidei Iudicium’ (1965) CLJ 260.
\end{flushleft}
2.2.2 BONA FIDES IN THE POST CLASSICAL ROMAN LAW, HIGH MIDDLE AGES AND FIRST PART OF THE MODERN PERIOD

The *Corpus Iuris Civilis* is a product of the Roman Empire in the East during the post-classic era. It is an epoch marked by strong central control. In fact, the *Corpus Iuris Civilis* is known as the work of the Emperor Justinian. At that time private procedure had changed from the antique *formulae* of the praetor to a central system, the *cognitio extra ordinem*. Such a system implied that the pronouncement in a case would come from the representative of the Emperor, similar to the administration of justice nowadays. The guidance of jurisprudence disappeared; consequently substantial institutions of law declined in the level of elaboration. This was due to the definitive instauration of absolutism by the Emperor Diocletian (284 A.D) and the radical decadence of the classical culture. As a result, the *iurisconsultus* who guided the elaboration and interpretation of the law disappeared. The writings of the preceding jurisprudence were called *iura* and were opposed to the prescriptions of the Emperor – named *leges*. However, the Justinian *Corpus Iuris* took place in an environment of revaluation of the classic jurisprudence by the Byzantine schools of law of the fifth and sixth centuries. It is during this post classic era that the principle of good faith assumed substantive meaning; it was a principle from which to derive rules of conduct for the parties and not any longer a characteristic of some type of process, those called *bonae fidei iudicia* in the old system – as studied earlier in this thesis.

In continental European kingdoms the law of Justinian was *ius commune*, applicable everywhere in the absence of special regional sources of law.26 The revival of the classical Roman law took place in Italy at the beginning of the eleventh century with the work of the glossators in Bologna.27

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26 The *ius commune* was applied in continental Europe from the tenth century until the codification process in the eighteenth century. At the beginning, England was excluded since at the time of the Norman invasion there was a law devoid of Roman influence. However, this situation changed over time: see n 35 and accompanying text of this chapter.

27 The scholars of the eleventh and twelfth century legal schools in Italy, France and Germany are identified as glossators. They studied Roman law based on the *Digestae*, the *Codex* of Justinian, the *Authenticae* (a reduced Latin translation of selected constitutions of Justinian, promulgated in Greek after the enactment of the *Codex* and therefore called *Novellae*), and his law manual, the *Institutiones Iustiniani*, compiled together in the *Corpus Iuris Civilis*. This title is itself only a sixteenth century printers’ invention [See with regard to this name: S E Thorne, ‘Statuti in the Post-Gossators’ (1936) 11 Speculum 452]. The glossators conducted
The school of Bologna considered Roman law as applicable law. The method adopted would come to mean the one applied by continental legal systems even today: decision making by way of subsuming a case under the terms of an abstractly formulated authoritative text or statute.

Italian commercial law permeated the whole of Western Europe. In this process the influence of Roman law was enormous. In a number of Italian cities (Como, Piacenza, Cremona, Bologna, Florence and Genoa) the merchants’ statutes expressly declared that the Roman law was to be followed whenever the statutes themselves were silent upon a point. The reasons for such a reference were the auctoritas (authority) of Roman law and the need to rely on a common law. Canon law was influential as well. The element of good faith was very strong here, sustaining the belief that the simple word of an honest man ought to be sufficient consideration to support a contract. Good faith as taken from the Church was associated with principles of the aequitas mercatoria aimed to provide merchants with elastic yet, at the same time, strong law to govern their contracts – mainly based on credit at that time. Good faith found an earlier acceptance within the law merchant to guard against fraudulent advantage from the technicalities of the law. Based on this principle mere consensus between the parties to a contract was enough to bind a contractor. Thus, in the evolution of law good faith facilitated commercial exchange and introduced social values within transactions.

detailed text studies that resulted in collections of explanations. For their work they used a method of study unknown to the Romans themselves, insisting that contradictions in the legal material were only apparent. They tried to harmonize the sources in the conviction that for every legal question only one binding rule exists. Thus they approached these legal sources in a dialectical way, which is a characteristic of medieval scholasticism.

The Italian cities laid the foundation of modern commercial and maritime law of Western Europe. The influence of Italian institutions and patterns of commercial and maritime tribunals was great upon Spanish seaport towns (Barcelona had particular importance which produced the famous body of laws known as Consolato del Mare); cities of Southern France such as Marseilles, Montpellier, Nimes and Narbonne were also influenced; as were cities and states of Northern Europe such as Champagne, Flanders, Geneva, Besancon, Frankfort on the Main, Leipzig and Cologne. Cf. W Holdsworth, A History of English Law Vol. V (3rd edn Sweet & Maxwell, London 1945) 60-154.


See A Lattes, Il Diritto Commerciale nella Legislazione Statutaria delle Città Italiane (U. Hoepli, Milano 1884)123.
In England Roman law started to be felt from the twelfth century in the following ways:

1) The teaching of the legal literature of the first Bolognese glossators. The doctrines of the glossators and even those of pre-Bolognese medieval Roman law influenced the intellectual organisation of English common law, and especially equity. During the medieval period there was a rapprochement between good faith (*bona fides*) and equity (*aequitas*);

2) Canon law, which was a synthesis of ecclesiastical sources and of a medieval interpretation of Roman law, was applied in English church courts whose jurisdiction included cases dealing also with contracts;

3) The application of principles of civil law (*i.e.*, a version of the *ius commune*) by the Court of Admiralty, the Star Chamber and the Ecclesiastical Courts.

In the light of the preceding remarks Wieacker states, ‘Common law and equity of the Anglo-Saxon orbit have shared, since the early part of the High Middle Ages, the tradition of European *ius commune* and *jus utrumque*’.

In general terms, it is possible to identify three periods of contact between the English legal system and civil law: a) during the early developments of centralised royal justice in the twelfth century; b) in the sixteenth century when the ‘process is made and justice is administered in the Admiralty Court according to the law civil’; and c) a final period of influence comes in the late seventeenth and early eighteenth centuries under the leadership of Lord Mansfield.

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33 W Senior in *Doctor’s Commons and the Old Court of Admiralty* (Longmans, Green and Co., London 1922) 16, states: ‘The early history of the Admiralty Court is admittedly obscure. We do not know the year of its beginning. The best authority only tells us that its origin can be traced “with tolerable certainty” to between 1340 and 1357, and that it was instituted to deal with piracy or “spoil” claims made by and against foreign sovereigns’.
34 Cfr. Wieacker (n 11) 259-260.
35 Wieacker (n 5) 6. The same author explains: ‘The term *ius utrumque* refers to the combination of secular, neo-Roman law (fashioned by Glossators and Commentators at the University of Bologna) and the canon law of the Roman Catholic Church applied by the ecclesiastical courts of Europe’.
36 Ibid 15.
In addition, in England in the fourteenth century the law applied in the merchant courts was the custom of merchants, a diverse body of rules with substantial civil law underpinnings. The law merchant and the law maritime were different from the common law.\textsuperscript{38} Here, Senior points out:

\begin{quote}
[we] may be sure that the good men of the town who dispensed justice on the quays of Ipswich and Bristol in the fourteenth century were unconscious of any connexion with the Digest. They knew that the law they administered was not the common law of England, though recognized and allowed; and they were acquainted with the pie-powder courts of the fairs administering the law merchant, which was not common law either.\textsuperscript{39}
\end{quote}

In the sixteenth century, as a result of the discoveries in the New World, trade was enlarged. For the first time maritime trade was made through new routes, reaching the most distant places of the world. The old mercantile society felt the effects of these events and underwent a metamorphosis; this marked the beginning of the modern era.

In the seventeenth century Lord Mansfield absorbed much of the law merchant and with that law some ideas from the civil law tradition into the English law.\textsuperscript{40}

Despite the fact that the contact between civil and English law took place during this period through the lex mercatoria, each system of law continued on its own path: continental law embraced good faith as a general principle, whereas the law of England enshrined it only in particular cases, for example in the contract of insurance.\textsuperscript{41}

\textsuperscript{38} Even as the roundness of the Globe of the world is composed of the Earth and Waters, so the body of Lex Mercatoria is made and framed of the Merchants’ Customs and the Sea Laws, which are involved together as the Seas and the Earth’. G Malynes, \textit{Consuetudo vel Lex Mercatoria} (First published 1622, Professional Books, Oxford 1981).

\textsuperscript{39} Senior (n 33) 20-1.

\textsuperscript{40} For an account on the influence of civil and canon law on the English law, see Wieacker, \textit{Foundations of European Legal Culture} (n 5) 6 ff.

\textsuperscript{41} In insurance contracts the principle has been developed specially during the pre-contractual period, \textit{i.e.}, during the formation of the contract. However, lately good faith has been invoked in the parties’ dealings after the contract is made. More important, the House of Lords appears to have accepted that the making of claims under an insurance contract was subject to a duty of good faith. The reasons for the lack of development of good faith as a general
In the modern era Europe experienced a cultural development known as Humanism. This is a complex phenomenon that in law meant the rediscovery of the classical Roman law without interpolations and gloss; it also implied that humanists despised Justinian because of his work – the Corpus iuris Civilis (these are known as the Anti-Tribonian). What they could not forgive of Justinian was that he collected only a part of the ancient Roman wisdom. They also severely criticized the jurists of the Middle Ages, since they hated to see the lines of the classical jurisprudence broken.

The modern period also witnessed good faith as dominating the scene of law merchant. Here, it was said:

*Bona fides est primum mobile ac spiritus vivificans commerci*

### 2.2.2.1 SUMMARY

The following general characteristics of good faith have been observed:
1. The universal character of good faith was preponderant during all these periods, because it was an essential element of many branches of medieval law – civil law, canon law and the law merchant – which share this principle in English law and the recent developments of this principle in insurance contracts are explained in Section 2.5.2 of this chapter.

42 Humanism was an intellectual movement in Europe which began in the fourteenth century and reached its peak at the time of the Reformation and Renaissance. Humanists reacted against medieval scholasticism by emphasizing human intellectual and cultural achievements, rather than such things as divine intervention, the brevity and misery of life and the need for escape. The movement began in Italy with a strong emphasis on study of the classics of ancient Greek and Roman civilization. The rediscovery of classical writings (not least the work of the Greek philosophers and scientists), and relaxation of the intellectual censorship which had been so characteristic of the medieval Church, led to a huge increase in philosophical, scientific and social study. It is no accident that the peak of humanist activity coincides with the first great period of European scientific research, with the work of such observers and thinkers as Bacon, Copernicus, Galileo, Harvey and Paracelsus. Bloomsbury Guide to Human Thought (1993) <http://www.credoreference.com/entry/bght/humanism> accessed 14 May 2011.

43 The classical period ran from roughly 27 BC to the middle of the third century AD.

44 Tribonian (died 545) was a Byzantine jurist, president of the legal commission that compiled the codification of Roman law sponsored by the emperor Justinian I.

45 See D Maffei, *Gli Inizi dell’Umanesico Giuridico* (Giuffrè, Milano 1956) passim. This author considers at p. 19 that Humanism in law started with the work of Irnerius (1050-1130), who discovered (that is, understood first) that law is all ‘hominum causa’.

46 Sanborn (n 29) 282.

47 ‘Good faith is the first motive and the spirit that gives life to commerce’ by Giuseppe Lorenzo Maria Casaregis, *Discursus Legales de Commercio ed de Avariis* (Genova 1707) 144.
cosmopolitan feature. Here, the universal good faith reached also England, as part of the *ius commune*, the law merchant and canon law;

2. During the post-classical era good faith assumed substantive meaning, *i.e.*, it became a principle from which to derive rules of conduct;

3. The canonist view of faith assisted the merchants and their tribunals to deal adequately with new forms of fraud and sharp practices and thus contributed to enforce high standards of good faith and fair dealing which are the life-sap of trade.

### 2.2.3 GOOD FAITH IN THE CODES

The codes found their foundation in the *ius naturalism* or the law of reason,\(^{48}\) which flourished during the early phase of the modern age. The law of reason undertook to deduce general rules or principles of law from the rational part of human nature. It sought for a law to be valid in the absolute and aimed to produce in codes a compendium of just norms.\(^{49}\) In this philosophy good faith is seen as ‘natural law’, therefore some norms impose the duty to perform agreements in *bona fides* and others refer to equity as a source of obligations. These norms are considered by jusnaturalists as universal and necessary.\(^{50}\)

However, some manifestations of the law of reason regarding good faith were not enshrined in the codes. For example, Samuel Pufendorf,\(^{51}\) a jusnaturalist who wrote at the end of the seventeenth century, during the period that preceded codification, stated that if an original or subsequent cause made unequal the reciprocal obligations, natural law declared that they

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\(^{48}\) The modern School of Natural Law refused to derive its principles from external systems such as divine law or the *Corpus iuris*. By means of rational study and criticism of human nature, the authors of this school searched for the self-evident and axiomatic principles from which they could deduce all other rules *more geometrico*. The title ‘law of reason’ is therefore more accurate than ‘natural law’, which has other connotations.

\(^{49}\) See Wleacker (n 5) 15-18.

\(^{50}\) To be a jusnaturalist means to be a supporter of the notion of natural law behind and above the positive law. For a debate about what does it mean to be a jusnaturalist today, see: Juha-Pekka Rentto, ‘Between Clarence Thomas and Saint Thomas: Beginnings of a Moral Argument for Judicial Jusnaturalism’ (1992) 26 U.C.Davis L.Rev. 727.

must be modified. This view was neither embraced in the Code Napoléon, nor in the German BGB (where it appears as a later development).

The triumph of enlightenment, natural law and the law of reason are represented in the Napoleonic Civil Code. At the time of the enactment of the Civil Code reason had become the guiding principle and its universality made the Code to impose itself over the auctoritas of the still prestigious Corpus iuris. Here, Van Caenegem states that, ‘The modern, more abstract method deliberately followed that of the abstract sciences, for the aim of the lawyers was to realize a universal science based on demonstrable propositions’.

In the Napoleonic Code, as in most codes of the civil law world, the rule on good faith is under the section named ‘The effect of obligations’ (effects des obligations) based, as stated before, on the jusnaturalist idea of the Code as a set of simple provisions with a general character to be accepted by all citizens. In consequence, the codes deal with good faith as a general principle. Even the German Civil Code is structured in this way (good faith is embraced as a general principle in Section 242 of the BGB), although the authors wanted to separate it from the jusnaturalism to align it with the Pandectists.

\[\text{Footnotes:}\]

52 It is important to note that, nonetheless, Pufendorf (n 51) 388, upholds the basic validity of the rule pacta sunt servanda. He points out that faith and confidence demand that in human society we must live up to our promises, ‘\textit{Si quae autem inter homines ineuntur pacta, illa sancte observanda esse, sociabilis natura hominis requirit}’.

53 The related paragraph reads as follows: ‘\textit{Ipsa tamen naturalis ratio ostendit, contractus onerosos esse bonae fidei, seu laxam interpretationem ex aequo et bono; ideo quod cum aequa in illis versetur obligatio, exinde neuer contrahentium gravetur. Contra autem benefici contractus stricti iuris videntur, nec laxam eiusmodi interpretationem admittunt, aut ut quis ad quid amplius, quam quod expresse significavit, adstringatur}’. Ibid 697.

54 Natural law had a preponderant role in the work of the drafters and theoretical fathers of the Code. During the Revolution natural law was also constantly invoked to justify new rules and new systems. Despite this background, the Code, in fact, came to establish the primacy of the statute and rejected all express reference to natural law.


56 It is worth noticing that the Swiss Civil Code contains the wider norm on good faith declaring it as essential condition for exercising any right: ‘\textit{Chacun est tenu d’exercer ses droit et d’exécuter ses obligations selon les règles de la bonne foi}’ (Rights and obligations must be exercised according to good faith). (Art. 2).

57 The exception is the Austrian Code (ABGB), which does not consider good faith as a general principle. The closest provision for good faith is article 914 that reads: ‘The interpretation of contracts shall not be based upon the literal meaning of the expressions used, but rather upon the true intention of the parties, and the contract shall be construed in accordance with the customs of honest dealings’.

58 Pandectists were German law professors of the nineteenth century. They studied Roman law based on the Digests or Pandects of the \textit{Corpus iuris Civilis} (534 A.D). Their achievement
A distrustful attitude of European scholars towards good faith became strong over the years because of the consciousness that it implies a value judgement to make it concrete. As a consequence of such a diffident attitude and also due to the decline of the école de l'exégèse, the systematic method appeared in the civil law of Europe. The supporters, mainly in Germany, pursued and organized a harmonic portrait of the regulae iuris. However, here the influence of the jusnaturalism was still alive, because the interpreters, while not believing the postulate of the naturalis ratio, took from that theory the core of the legal phenomenon.

The Industrial Revolution, which changed Europe’s face, brought about a distrustful view of the rule of good faith. Therefore, in order to avoid the risks of elastic precepts, the German jurists of the nineteenth century preferred not to comment on this norm. The idea of removing attention from good faith in the contract is explained by:

1) the fear of value judgments (necessary to materialize the norm);
2) Individualism dominating the scene, which required consideration of the wish of the parties and denied that the judge could enrich or correct it.

Despite the juspositivist premises propagated in nineteenth century Germany, good faith is present in the BGB. In spite of the sharp position against the postulates of the naturalis ratio, and although the Pandectists rejected any residue that arose from the memory of metaphysics, the scholars failed to exclude good faith from the legal language. Perhaps they believed that it would become just an aphorism without practical consequences. The reality would demonstrate that the result was exactly the opposite.60

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59 The principal task of this School was the exegesis of individual texts of the Corpus Iuris in order to harmonize them. In France and Italy the important role of exegesis is explained by the understanding of the codes as a body of rules and symbol of the national and political unity of the country, therefore the systematic method – which aims to deduce concrete rules of positive law from general concepts and axioms – did not fit well.

60 See Section 2.4.2 of this chapter.
In England, nonetheless, the concept of good faith did not take off. This is usually explained by the presence of the subjective classical doctrines of freedom and sanctity of contract in the nineteenth century.\(^{61}\) (However, the reasons for this development are specifically analysed in the relevant part of this thesis).\(^{62}\) It was considered that all the consequences of a contract derived from the will of those who made it and that they were the best judges of their own needs and circumstances. It followed that the unfairness of the bargain was irrelevant. As Atiyah states:

This equation of general principles of contract law with free market economy led to an emphasis on the framework within which individuals bargained with each other and a retreat from interest in substantive justice and fairness. The model of contract theory which implicitly underlay the classical law of contract was thus the model of the market. Essentially this model is based on the following principal features. First the parties deal with each other ‘at arm’s length’ in the legal phrase; this carries the notion that each relies on his own skill and judgement and that neither owes any fiduciary obligation to the other.\(^{63}\)

There is a later development in English law which is examined in the relevant part of this chapter.\(^{64}\)

### 2.2.3.1 SUMMARY

The codes, as the product of the law of reason, embrace good faith as a general principle. However, the extent of the embracement varies. In the French Civil Code, for example, some norms impose the duty to perform agreements in good faith and others refer to equity as a source of obligations. These norms were considered by jusnaturalists as universal and necessary, whereas in the BGB, although good faith was enshrined as a general principle, it was hardly considered by the jurists of the nineteenth century, since the necessary intervention of the judge to concretize the principle


\(^{62}\) See Section 2.5.2 of this chapter

\(^{63}\) Atiyah (n 8) 402.

\(^{64}\) See Section 2.5.2. This development of English law was foreseen by Atiyah in *Freedom of Contract and the New Right* (Juridiska Fakulteten i Stockholm 1988).
generated distrust. However, this reality would evolve over the years. Nowadays, it is considered that, ‘under the German law a contract appears as a kind of a living and dynamic organism which forms a cooperation relationship between the parties and contains a strong good faith/reliance element and additional implied obligations’. This evolution and the current state of national laws as regards good faith are the subject of the following section.

2.3 GOOD FAITH IN CIVIL AND COMMON LAW: AN OVERVIEW

The tendency of a legal system to embrace good faith or explicitly require it in a narrow range of particular situations is likely to be related to a number of historical, cultural and institutional factors.

As has been shown hitherto, the concept of good faith is not static. For example, the notion of good faith has evolved recently in countries such as Canada and Australia, which have in the past tended to follow the distrustful English lead – with regards to good faith – in the development of their contract law. Another example is the mixed system of Scots law, in which good faith appears to be increasing its influence.

In civil law countries good faith is accepted as a general principle of contract law. However, it is not always understood in the same way.

Good faith has allowed continental judges to create new solutions without invading the area of the legislator. The German example where judges have overcome obstacles and legal gaps deriving the decisions under section 242 BGB is conspicuous, as will be seen.

65 Magnus (n 58) 98.
66 Further to the distrustful approach of English law it has been said: ‘It is clear that fairness and certainty are often assumed to be opposed values in the English law of contract. The connection between good faith and uncertainty is generally cited as a logical or necessary one’. N Lomax, ‘The Future Role of Good Faith in the English Law of Contract’ (LLM thesis, University of Oxford 1996) 61.
Sometimes contractual good faith reaches, in continental law, such levels of amplitude that, for example, in Italy its creative role has been recognized. Two leading scholars testify so. Galgano asserts, ‘The principle of good faith allows identifying other prohibitions and duties besides those foreseen by the law’. Massimo Bianca states that, beyond the role of integration that good faith plays, the principle prevails even over the determinations and clauses of the contract. The Italian courts have embraced this view as well: a recent verdict by the *Corte di Cassazione* has affirmed the criterion that good faith is an instrument in the judge’s hands to control and even to modify and integrate the agreement.

The award n.76/98 of 24 November 1999 is an example of the great extension attributed to this duty. This is an international arbitration decided on the basis of the Italian *Codice Civile*. The case was conducted before the Italian Arbitration Association in Florence. The claimant was an exclusive distributor (in Denmark) and the defendant, the licensor of distribution rights (in Italy).

At the basis there was an exclusive distributorship contract concerning Denmark and Scandinavian countries entered into by the parties in August 1995. The main obligations undertaken by the parties were:

- **Claimant:** to keep defendant informed about its customers and promptly notify any act of unfair competition;
- **Defendant:** to invest 3% of the total sales volume in advertising in Scandinavia, to supply high quality goods and to protect the trademark in the exclusive distributorship territory.

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73 Unfair competition means an attempt to do better than another company by using methods such as importing foreign products at very low prices or by wrongly criticizing a competitor’s products.
The controversy arose fundamentally as a consequence of the requested termination of the contract under allegations of partial and late deliveries by the respondent and refusal to accept returns of defective and late deliveries of goods. The claimant also alleged that there had been parallel imports of a specific product in the Scandinavian countries by exporters in the country of the original licensor. The defendant refused to act against the exporters, therefore the claimant sued on his own in the country of the original licensor.

The arbitral tribunal granted the distributor’s claim based on the defendant’s failure to protect the trademark. The arbitrators held that, although the contract only provided that the distributor assist the licensor in the protection of the trademark, that did not mean that, in general terms, a similar duty of assistance and cooperation should not be fulfilled by the defendant as well. It was held that the defendant ought at least to have cooperated with the claimant, providing him with appropriate support. Such a conclusion is on the basis of article 1375 of the Italian Civil Code to perform the contract in accordance with good faith, ‘to be understood as an “undertaking in cooperation and protection of the interests of the other party to the contract”, operating “beyond specific provisions” of the agreement and not capable of exclusion by the will of the parties’ (quoted from Cass. 6 February 1997, n. 1123; Cass. 11 January 1983 cites a duty of cooperation and mutual trust as a source of legitimate expectation).

As stated above, the meaning of good faith has changed over the years. In Dutch law even the term good faith is not used in the Civil Code (which was substantially reformed in 1992) but ‘redelijkheid en billijkheid’ (reasonableness and fairness), which is considered more objective. This concept has been elevated to a rank above custom and statutory law and may affect and correct the application of both, at least in contract law, as provided in article 2 of book 6 of the Burgerlijk Wetboek (BW).74

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74 Art. 6:2 of the Burgerlijk Wetboek (BW)  
1. A creditor and debtor must, as between themselves, act in accordance with the requirements of reasonableness and fairness.
Good faith in continental law is not just a well-established doctrine, but there is also increased sensitivity for the requirement of good faith. For instance, the past decades have seen a significant rise in the number of duties of disclosure in consumer contracts and even between entrepreneurs found by the courts.\textsuperscript{75} The courts of France and Germany have held that a contractor, badly advised by the other party or led to contract by the mere silence of the partner, may authorize an action for damages and the possibility to claim release from the legal consequences of the contract, even if the preconditions for fraud are not present.\textsuperscript{76} The new German law of obligations that came into force on 1 January 2002 is another example. This massive reform incorporated into the BGB theories already accepted \textit{praeter legem} in the German legal culture. The following – newly incorporated – theories are a clear expression of the increased sensitivity towards good faith:

- Culpa in contrahendo §311 II BGB;\textsuperscript{77}
- Change of circumstances (\textit{Störung der Geschäftsgrundlage}) §313 BGB;\textsuperscript{78}
- The possibility of terminating, for a compelling reason, contracts for performance of a recurring obligation §314 BGB;

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\textsuperscript{2} A rule binding upon them by virtue of law, usage or a juridical act does not apply to the extent that, in the given circumstances, this would be unacceptable according to criteria of reasonableness and fairness.

\textit{Article 6:248 BW}

1. A contract has not only the juridical effects agreed to by the parties, but also those which, according to the nature of the contract, result from the law, usage or the requirements of reasonableness and fairness.

2. A rule binding upon the parties as a result of the contract does not apply to the extent that, in the given circumstances, this would be unacceptable according to criteria of reasonableness and fairness.

\textsuperscript{75} The catalyst for this change has been, in many cases, EU law. For example, the Unfair Contract Terms Directive (1993/13/EEC) introduces a notion of good faith in order to prevent significant imbalances in the rights and obligations of consumers, on the one hand, and sellers and suppliers, on the other hand.


\textsuperscript{77} Section 311. Obligations created by legal transaction and obligations similar to legal transactions.

\textsuperscript{78} See n 134 of this chapter.
The duty to have regard to the other party’s rights and interests which may result from the content of the obligation §241 BGB; or the existence of such duties on the part of third parties.  

In common law, good faith, as a general principle, is accepted by the law of the United States, whereas English law has refused to develop the principle as a general one.

As is widely known, English law has hitherto declined to adopt a general principle of good faith. It has been said by a leading author that, ‘the predictability of the legal outcome of a case is more important than absolute justice’. A civil law author, Hein Kötz, comments on this approach:

The English do not seem to appreciate that the technique of going forward cautiously from this case or that case, as justice in each case requires, is equally possible where the judge has to work on the basis of a loosely – textured statutory formula, such as good faith principle. Some of them believe that such form would be positively dangerous.

Nonetheless, good faith’s force is also at work in common law. Outside the U.S., however, it is unlikely to be referred as good faith. Lord J Bingham maintains that, ‘English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness’. Here, Collins’s position is that when the courts are confronted by a manifestly disadvantageous transaction, they could deploy a host of legal doctrines in order to avoid enforcement. Besides, courts deploy other tools to support transactions that are regarded as commercially beneficial.

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80 See Section 2.5.1 of this chapter.
81 See Section 2.5.2 of this chapter.
82 R Goode, The Concept of “Good Faith” in English Law (Centro di Studi e Ricerca di Diritto Comparato e Straniero, Roma 1992) 9. See n 244 of this chapter.
84 In Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989] QB 433 (CA).
85 Cf. H Collins, The Law of Contracts (4th edn LexisNexis, London 2003) 272. The various techniques used by common law judges to achieve similar results are, inter alia:
McKendrick postulates that good faith is recognized by English courts in the negotiation stage by the terms ‘best endeavours’ and ‘reasonable endeavours’. In the case of Terrell v Mabie Todd & Co Ltd, the licensees were required to use ‘all diligence’ to promote sales of inventions and designs and to use their ‘best endeavours’ to exploit these. The obligation to use ‘best endeavours’ requires the party to do what is commercially practicable; thus, McKendrick compares ‘best endeavours’ with what is reasonable and prudent, equating these concepts with good faith. This is a challenging idea since the House of Lords in the famous case Walford v Miles declared the obligation to negotiate in good faith unenforceable.

86 (1952) 69 RPC 234
O’Connor maintains a similar position of good faith behind the scenes: ‘The judicial imposition of good faith is still cloaked in technical devices. The invention of the doctrine of promissory estoppel to give effect to promises unsupported by consideration is another well-known, bolder example of judicial imposition of good faith’.  

It has been suggested that the function of good faith is carried out in common law by equity: ‘Equity has played a major role as a stand-in for good faith in English commercial law’. However, equity is not a general concept allowing the entrance of general notions of fairness. Equity is used by judges as a last resort, except in areas entirely covered by it, like trusts, agency, company and bankruptcy law. Beatson and Friedmann point out that,

> Even before the European Community Directive on Unfair Terms in Consumer Contracts of 1993, which imposes obligations of good faith, there were signs that the influence of other legal systems and the European environment were leading to a gradual recognition of the doctrine or at least to parallel solutions by other means (in English law) (parenthesis added).

In fact, the aforementioned Directive overlaps substantially with a previous regulation: the Unfair Contract Term Act 1977. Despite the name of the Act, it is concerned only with exemption clauses in contracts, providing that the validity of such clauses depends on what has been called ‘a reasonable test’.

The Directive of 1993 provides that a term which has not been individually negotiated is unfair if, contrary to the requirements of good faith, it causes a significant imbalance in the rights and obligations of the parties to the detriment of the consumer – taking into account the nature of the goods or services and the circumstances attending the making of the contract. As Atiyah states:


> ECC 93/13, 5 April 1993. See the analysis of the Directive in Section 2.5.2 of this chapter.

In assessing good faith, particular regard must be had to the bargaining position of the parties, whether the consumer had an inducement to agree to the terms, whether the goods or services were sold or supplied to the special order of the consumer, and the extent to which the seller or supplier has dealt fairly and equitably with the other party whose legitimate interests he has to take into account. ³³

These requirements to assess good faith, especially the first three factors, were already included in the test of reasonableness under the 1977 Act, as they appear in the Schedule 2 “Guidelines” for Application of Reasonableness Test.

This tour d'horizon has been pursued in order to identify roughly the position of good faith in the main Western legal traditions considered in this study. In the following account the aim is to make clear their particular understanding of good faith in order to determine in the next chapters whether they have influenced the meaning of the principle in the lex mercatoria. In support of this theory about the influence of national systems, the UNIDROIT Principles of International Commercial Contracts state in art. 1.7 that good faith must be applied in accordance with its understanding in international trade, not in accordance with the usual criteria adopted in the different legal systems, ‘even though comparative analysis is, of course, the basis upon which the principle of good faith as now used in international trade was developed’. ³⁴

³⁴ Fauvarque-Cosson and Mazeaud (n 32) 174.
GOOD FAITH IN CIVIL LAW

GOOD FAITH IN FRANCE

Despite the generality of the formula of article 1134 in its declaration that contracts ‘doivent être exécutés de bonne foi’, French law remains hesitant in its approach to good faith, even considering that article 1135 of the Code Civil contains also a general statement:

Les conventions obligent non seulement à ce qui y est exprimé, mais encore à toutes les suites que l'équité, l'usage ou la loi donnent à l'obligation d'après sa nature.

In general, French law has used the concept of good faith in performance to avoid onerous conditions. It limits the use of the concept as a corrective of the contractual terms to particular areas by using the well-established theory of the abuse of rights (abus de droit).

The unfruitfulness of good faith in French law is ascribed to ‘an attempt to put good faith on too high a moral plane’. Here, Yves Picod emphasizes the contrast between the obligatory force of the contract on the one hand, and, on the other, the necessity to reconcile it with the exigencies of the moral order. He makes the point based upon line 1 and line 3 of article 1134 of the Code Civil. He calls the latter a ‘frein harmonieux’ of line 1.

95 ‘Agreements must be performed in good faith’. The Project of the Code Civil contained an article according to which: ‘Les conventions doivent être contratées et exécutées de bonne foi’. The reason why good faith was excluded during formation was the accidental fact that article 1134 is part of the chapter ‘De l'effet des obligations’. Cf. D Tallon, Le Concept de Bonne Foi en Droit Français du Contrat (Centro di Studi e Ricerca di Diritto Comparato e Straniero, Roma 1994) 3.

96 ‘Agreements are binding not only as to what is therein expressed, but also as to all the consequences which equity, usage or statute give to the obligation according to its nature’.


100 ‘Harmonious brake’.

The following is the English translation of article 1134:

Agreements lawfully entered into take the place of the law for those who have made them.
They may be revoked only by mutual consent, or for causes authorized by law.
They must be performed in good faith.

The moral aspect of good faith in French law is due to the canonist tradition and the doctrine of Domat, one of the inspirers of the Civil Code of 1804. This was reinforced by the moralizing notion of natural law.

In the twentieth century, specifically in the 1930s, scholars saw good faith as a tool in the judge’s hands for adjusting the contract to new and unforeseen events in opposition to the inflexibility of articles 6 and 1134 line 1 of the Civil Code. To the question of whether such flexibility of the contract could bring more trouble than benefits, the scholars answered that they rather feared a ‘révolte des faits contre le Code’. Ripert in ‘L’Ordre Économique et la Liberté Contractuelle’ considered that the regulation of the contract had passed from flexible to semi-rigid. In his view, the legislator had supplanted the parties in the regulation of contractual obligations under the pretext of law and order. To avoid the limitation of contractual freedom, he advocated for a tool in the judges’ hands which allows shaping the contract according to the circumstances. Ripert stated that it is difficult to find a technical way for that, but he imagined several ones in the theory of imprévisio, which is a theory that had been applied on numerous occasions by the Counseil d’Etat and

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103 Josserand, for example, in ‘Le Contrat e la Loi’ in Recueil d’Études sur les Sources du Droit. En l’Honneur de François Gény (Librairie du Recueil Sirey, Paris 1934) states that the same law (articles 1134, para. 3 and 1135 Code Civil) directs the judge towards good faith in order to find new obligations and adapt the contract according to individual, economic and social phenomena. In this sense, according to the author, ‘C’est qu’en effet, dans le droit modern, tous les contrats sont de bonne foi’, i.e. The fact is that, in modern law, all contracts are in good faith’. See also: R Vouin, La Bonne Foi (Libraire Générale de Droit et de Jurisprudence, Paris 1939).
104 ‘A rebellion of the facts against the Code’.
105 In Recueil d’Études sur les Sources du Droit. En l’Honneur de François Gény (Librairie du Recueil Sirey, Paris 1934).
other administrative courts, allowing the adjustment of administrative contracts due to the public interest involved.\textsuperscript{106}

At the end of the fifties and during the sixties good faith started to be accepted by courts.\textsuperscript{107}

It is submitted here that the germ of the relevance of good faith had been always there. Portalis, for instance, in the Preliminary Discourse of the Project of the Civil Code put good faith on the same level as equality of agreements when he said, ‘\textit{Il faut de la bonne foi, de la réciprocité et de l’égalité dans le contrats}’.\textsuperscript{108}

In the eighties the idea advanced by authors in the fifties and sixties – \textit{i.e.}, good faith as an element in the judge’s hands to adjust the contract – is established among scholars\textsuperscript{109} and recognized by some judicial decisions. \textit{E.g.} Mestre in the \textit{Revue Trimestrielle de Droit Civil} stated that:

\begin{quote}
The contract has become a place of necessary equilibrium, which the legislator and the judge must not hesitate, in certain cases, to restore, by eliminating abuses related to economic or technical inequalities...Would not the contract become the juridical instrument for collaboration between the parties? (emphasis added)\textsuperscript{110}
\end{quote}

The author considered that, without doubt, the duty to collaborate has its roots in the requirement of good faith contained in article 1134 line 3 of the Civil Code, ‘which recently has had a particular favour in the courts’.\textsuperscript{111}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{106} In this regard, the case \textit{Compagnie Générale d’Éclairage de Bordeaux} is well known, CE 30 March 1916, \textit{Sirey} 1916, 3, 17. In March 1904 the city of Bourdeaux had given the gas supply’s concession for the entire city to a private company. The gas was used for public lighting. The price was fixed at 8 cents per cubic meter. The beginning of the First World War caused the coal’s price to rise sharply, making burdensome for the concessionaire to provide the service under the current circumstances. The attempt to deal amicably failed. Therefore, the case was taken to the Administrative Court which rejected the claims aiming to modify the contract. However, the \textit{Conseil d’Etat} held for the plaintiff in the last instance.
\item \textsuperscript{108} ‘Good faith, reciprocity and equality in contracts must be considered’. J E M Portalis, \textit{Discurso Preliminar del Proyecto de Código Civil Francés} (EDEVAL, Valparaíso 1978).
\item \textsuperscript{110} J Mestre, ‘Obligations et Contrat Spéciaux’ (1986) RTD Civ. 100-1.
\item \textsuperscript{111} Ibid. See Gaz.Pal. 8-9 March 1985, Panorama 20 obs. J Dupichot; see also Tallon (n 95) 4.
\end{itemize}
\end{footnotesize}
Morin regrets the lack of development of a more objective construction of the good faith enshrined in article 1134 of the Civil Code in the following terms, ‘Although French courts rarely invoke article 1134 of the Civil Code to sanction a party’s failure to cooperate during contractual performance, this article may be applied more often as commercial transactions requiring the parties’ cooperation multiply’.  

Here, in recent years it is possible to notice in courts’ decisions a deepening of this perspective due to the influence of solidarism, which is a minority theory in French law but still influential.

The political doctrine of solidarism was formulated by Léon Bourgeois in his work ‘Solidarité’; Durkheim and Duguit, among others, introduced the concept of ‘Contractual solidarism’. This doctrine seeks to reconcile the classic imperatives of stability and legal certainty with, inter alia, principles of solidarism, proportionality and coherence.

Solidarism in contract law seeks the adaptation of those relations that are not equal, giving the judge the power to adjust them. It requests of the parties a form of collaboration and mutual help. It is based on good faith and loyalty.

It is possible to consider the evolution of the theory of imprévison in French law as an example of the return of solidarism in contracts. At the beginning (after the Code Napoléon) jurisprudence was reluctant to intervene in cases of contract that became extremely onerous for one of the parties. The case ‘Crapone Canal’ (1876) is famous. The Tribunal declared:

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113 Léon Bourgeois (1851-1925) was a French statesman and prime minister (1895-96). He was the chief theorist of solidarism, the concept that an individual's rights in society must be balanced by his responsibility to it. Prominent in the League of Nations, he won the Nobel Peace Prize in 1920. The Macmillan Encyclopedia (2003) <http://www.credoreference.com/entry/move/bourgeois_l%C3%A9on_1851_1925> accessed 15 May 2011


115 See L Grynbaum and M Nicod (eds), Le Solidarisme Contractuel (Economica, 2004).

116 See n 106 and the text that accompanies it.
Il n’appartient pas aux tribunaux, quelqu’équitable que puisse leur paraître leur décision, de prendre en considération le temps et les circonstances pour modifier les conventions des parties et substituer des clauses nouvelles à celles qu’elles ont librement acceptées.\footnote{It is not for the courts, although it seems equitable, to take into consideration the time and circumstances in order to modify the parties’ agreements and substitute new clauses to those that they have freely accepted’. Cass.Civ. 6 March 1876 DP 1876.I.197.}

However, nowadays there are some decisions on the duty to renegotiate based on good faith\footnote{See Cass. Civ. 3 March 1992 and its comment by Mestre RTD Civ 1993, 124. For Mestre the importance of this decision is the recognition of: ‘Good faith enshrined in article 1134, which requires the party to modify, during the life of the contract, a system of obligations freely or conventionally fixed at its origin due to new circumstances that make the fulfilment more onerous and leave it in a precarious situation’.} and there is also a French Reform Proposal providing for renegotiation of the contract in the case of change of circumstances.\footnote{See Fauvarque-Cosson and Mazeaud (n 32) 189 n. 145. See the \textit{avant-projet de réforme du droit des obligations et de la prescription} translated into English in: <http://www.justice.gouv.fr/art_pix/rapportcatatla0905-anglais.pdf> accessed 8 May 2011.}

Picod maintains that the judges in France recognize the duty of good faith (in its form of cooperation) of creditor and debtor. The author provides several examples in which they have recognized the creditor’s obligation to facilitate to the debtor the performance of his obligations.\footnote{Picod (n 101) 108.}

There is an interesting case: the Court of Appeal of Colmar declared that a farmer, who at the moment of installing himself had found buildings dilapidated, land abandoned and, who consequently, has spent huge sums of money, is protected from being asked the immediate payment of a higher rent. That would be against good faith.\footnote{Ibid 109 n 34.}

Furthermore, from the point of view of the performance of the contract solidarists consider the \textit{abus de droit}, not only as the intention to damage but, as including the absence of cooperation. The arbitral award in \textit{Klöckner v Cameroon} illustrates this. Here, relying on what it is considered a general principle of French law, the majority boldly stated:

We assume that the principle according to which a person who engages in close contractual relations, based on confidence, must deal with its partner in a frank, loyal
and candid manner is a basic principle of French civil law, as is indeed the case under the municipal codes which we know of.\textsuperscript{122}

Particularly enlightening in the ambit of international transactions is an arbitral decision given by the ICC applying French Law.\textsuperscript{123} In this award the duties of confidentiality and information are considered as stemming from the general duty of good faith, understood as cooperation.

The claimant was a licensor (France) and the respondent, a licensee (U.S.). The parties of the dispute were company M (claimant), which had developed a specific type of equipment to produce its trademark product and a United States corporation (respondent), which had been granted the license for the manufacture and sale of the product in the United States and Canada. The corporation agreed to pay an ongoing royalty to use any improvement of the know-how and/or the patents.

The dispute arose between the parties regarding the following issues:

In 1997, the respondent sold the product to a company in country X without informing the claimant of such sale. Shortly thereafter in 1997, the respondent was contacted by another country X’s company inquiring about the availability of the product for distribution in country X. The respondent sent a sample shipment of 15,000 units of the product. Later, in 1999, this second country X’s company provided samples to an institute which used them in a comparative study.

The product delivered by the respondent to the second country X’s company was rated extremely poor. The claimant then learned that the samples in the study had been supplied by the second country X’s company and that that company had presented itself as the agent for the product in that region.

The claims in summary were: breaching of the contractual obligations by selling the product outside the contractual territory; continuation of sale of

\textsuperscript{122} For a translation of the annulment in Klöckner v Cameroon see (1986)1 ICSID Rev - FILJ 89. Delaume dissented from this award because he denied the existence of the duty of full disclosure that goes beyond the elementary requirement of good faith. He stated that, ‘The tribunal made no specific reference to French law or other municipal codes to substantiate its determination. Unfortunately, the determination finds no support in French law’. G Delaume, ‘The Myth of the Lex Mercatoria and State Contracts’ in T Carbonneau (ed) \textit{Lex Mercatoria and Arbitration} (Kluwer Law International, London 1998) 122.

\textsuperscript{123} This is award n. 12127 in (2008) 33 Yb Comm. Arb’n 82.
the trademark product after the termination of the contract; breaching the confidentiality agreement; and, *inter alia*, damages for the publication of the study.

The arbitral tribunal upheld the claimant’s position on the territory limitation. The tribunal found that it was ‘common practice of exclusive license agreements to entitle the licensee to perform both production and distribution and to include a territorial limitation of the licensee’s activities’. Moreover, the arbitrator found that the respondent had failed to inform the second country X’s company that it had no authority to appoint agents or representatives for the product in that region. The arbitral tribunal also rejected the respondent’s argument that, because deliveries had taken place FOB in the United States, they did not constitute a violation of the territorial restriction. The respondent’s actions were considered as violation of article 1134 of the French Civil Code which requires parties to perform their obligations in good faith, which is not satisfied when a party knows that it is circumventing the intention of the contract.

In respect of the duty of information, even though the contract did not expressly provide for a clause obliging the licensee to inform the licensor of facts and circumstances pertinent to the trade-mark and patent’s protection, the tribunal believed that the respondent was effectively under such obligation. The importance of this part of the award is that such information obligation was considered as a general consequence of article 1134 of the French Civil Code, according to which contracts have to be performed in good faith. This demonstrates the trend pointed out before, *i.e.*, that, as a matter of fact, case law and scholarship are agreed that good faith performance implies a degree of cooperation between the parties.
2.4.2 GOOD FAITH IN GERMANY

The terms used in the Bürgerliches Gesetzbuch (BGB) to mean good faith are Treu und Glauben. Altogether they mean objective good faith, that is, a standard of conduct or, better, a general principle.124

Good faith in the German law of contract is fundamental and has had an enormous impact without adversely affecting the certainty of the law. The basic norms in the BGB are §§157 and 242.125 The core disposition, §242, reads as follows:

The debtor is bound to perform according to the requirements of good faith, ordinary usage being taken into consideration

Since 1920 courts in Germany have shown a tendency to quote both provisions simultaneously.126

§242 is a general principle of the law of obligations; it is a general clause which does not enunciate any precise duty, although it is possible to deduce parameters of behaviour susceptible of definition at the time of their application: ‘The fideis uberrima of §242 – as all general clauses in proper sense – is a reference to experiences, rules and maxims to be updated in foro’.127 The general clause contained in §242 allows each decision based on it to contain elements of a new creation of law. It is a ‘law in making’, in Wieacker’s wording.128

124 What is the real nature of good faith: legal standard or general principle of law? Standard is an instrument of method; typical standard is the bon père de famille. The standard is built for a particular case. It is a tool of the arbitrator or judge to be used in a discretionar已然 way. The rule of law and the principles of law are elements of stability of law, imperative, abstract and non individual; they impose themselves on everyone, even the judge. Good faith has always had the general character attributed to principles of law. Though it is specified according to the circumstances of the case, it conserves its general aspect and abstraction. See Vouin (n 103) 93. As regards the necessity of having general rules and principles, see W Frankena, Ethics (Prentice-Hall, New Jersey 1973).

125 §157 BGB: Contracts shall be interpreted according to the requirement of good faith, ordinary usage being taken into consideration.


127 Wieacker (n 17) 40.

128 Ibid 39.
It has been said that what an English judge deduces from the contract and calls ‘implied condition’ is added to the contract by the German judge by virtue of the principle of good faith.\textsuperscript{129} Such generality has allowed §242 BGB to act as a source of duties that later become independent. This is what has been called *Ergänzungsfunktion*.\textsuperscript{130} Section 242 has given rise to a creative construction and, therefore, ancillary duties derived from good faith have even become new prescriptions of the BGB.\textsuperscript{131}

A further problem in the original BGB was the absence of consideration of the change of circumstances. This was a consequence of the hostile position of the nineteenth century legal science towards the clause *rebus sic stantibus*,\textsuperscript{132} which confronted the freedom of contract and economic liberalism prevailing then. Therefore, the interpretation of §242 by courts in the aftermath of the First World War brought about the ‘Doctrine of Contractual Basis’ (*Lehre von der Geschäftsgrundlage*):

According to this theory, which is based on the traditional notion of clause *rebus sic stantibus*, the ‘basis’ of the contract is the *assumption shared* by the contracting parties that certain circumstances which they regard as important are either existing or will come about, even though this assumption was not expressed in their declarations exchanged when making the contract (emphasis added).\textsuperscript{133}

The ‘assumption shared’ was highlighted in the foregoing quotation because the original formulation of Bernhard Windscheid (1817-1892), possibly the most influential of the Pandectists of the nineteenth century and chief drafter of the first version of the Civil Code, did not consider this aspect of shared perspective of the ‘inchoate condition’ which became known as *Lehre von der Voraussetzung*. This defect affected those who considered that

\begin{itemize}
\item \textsuperscript{129} K. Larenz, *Base del Negocio Jurídico y Cumplimiento de los Contratos* (Editorial Comares, Granada 2002).
\item \textsuperscript{131} §§ 554 a, 626, 723 BGB have come to be seen as specific statutory emanations of the principle of good faith.
\item \textsuperscript{132} See Chapter One n 85.
\end{itemize}
this would allow one party to pass its own risks onto its co-contractor. The theory was ‘corrected’ by Oertmann, who established that,

The basis of the transaction is the ‘assumption made by one party which has become obvious to and acquiesced in by the other’ that certain circumstances which they regard as important are either existing or will come about, even though this assumption was not expressed in their declarations exchanged when making the contract.\textsuperscript{134}

German contract law has given importance to the change of circumstances on the basis of the good faith principle, to the point of modifying the foundations of the contract. The German reform of the law of obligations in 2002 embodied such considerations, introducing the new §313 in the BGB.\textsuperscript{135}

Besides the aforementioned functions of Section 242 BGB, namely the function of allowing German jurists to create supplementary duties and to adjust contracts affected by new circumstances, there would be two other functions:

The function of restriction has to be mentioned. Based on Section 242 BGB, the courts frequently prevent a certain right from being abused or carried to an extreme...In addition, Section 242 BGB functions as a platform for the applicability of the German Constitution, the so-called ‘Basic-law’ (Grundgesetz) into private law.\textsuperscript{136}

It is considered that German law has been highly influential in the ways to tackle the change of circumstances and ancillary duties in the lex

\textsuperscript{134} Markesinis, Lorenz and Dannemann (n 126) 318.
\textsuperscript{135} Section 313: Interference with the Basis of the Transaction
(1) If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration.
(2) It is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect.
(3) If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may withdraw from the contract. In the case of continuing obligations, the right to terminate takes the place of the right to withdraw.
mercatoria. Regarding the first aspect, even though the clause *rebus sic stantibus* finds its historical origin in Aquinas’s *Summa Theologiae*,\(^\text{137}\) it was German law which – despite the initial opposition by the drafters of the Code to incorporate the change of circumstances – dealt with it in the aftermath of the First World War. This new way to face the issue is embraced in the lex mercatoria.\(^\text{138}\) For example, the Principles of European Contract Law (PECL) and the Principles of International Commercial Contracts (PICC or UNIDROIT Principles) have both introduced the concept of adjustment of the contract due to supervening events, though with fundamental differences in respect to Section 313 BGB.\(^\text{139}\) Schlechtriem offers a clear account of these differences:

> While PECL requires a change of circumstances after conclusion of the contract, § 313 (2) BGB allows adjustment also in case of a mutual error of the parties as to the factual foundations of the contract. While the uniform law projects see as an initial step a request by the disadvantaged party for renegotiations, §313 BGB has no such requirement but allows an aggrieved party to claim adjustment of the contract without preliminary negotiations. Most important, while the uniform law projects allow the courts to adjust the contract affected by changed circumstances at their discretion, §313 (1) requires that the party asking for adjustment must claim for a specific alteration of the contract, which the court can either grant or deny. And while §313 (3) BGB envisages termination of the contract in these cases only as a remedy of last resort, the uniform law projects leave it to the discretion of the courts whether they terminate the contract or alter its terms.\(^\text{140}\)

As regards ancillary duties, according to Sections 280 (3), 282 and 241 (2) BGB the creditor is entitled not only to receive performance but a proper one. From the point of view of both parties, each of them must be considerate


\(^{138}\) It is considered a new way to face the change of circumstances in comparison with other legislations rather scarce in effective solutions, *e.g.* French Civil Code regulates the fundamental alteration of the equilibrium of the contract by events which occur after the conclusion of the agreement in a very severe manner through the theory of imprévision.

\(^{139}\) These set of rules, with European and universal reach respectively, attempt to offer the common core of contract law to trade operators that want to abstain from national legislations. They have been made by private institutions and, therefore, are not binding over the parties. It is considered that they reflect in part the current lex mercatoria. See Chapter Four, Section 4.2 and 4.3.

with regard to each other’s rights and legal interests. This outlook, which considers that a proper performance includes those duties directed to facilitate the performance of the other party, reveals that there is a cooperative perspective of the contractual relationship in German law.

This view is confirmed in the recapitulation of the classic book of Wieacker, *Zur rechtstheoretische Präzisierung des §242 BGB*, where the author states:

In the field of what has been called *officium iudicis* the current text of paragraph 242 expresses its function in a clear and accurate way. Furthermore, the debtor must fulfil his duty and the creditor must require it according to good faith... In this manner, the paragraph 242 is better suited to the vanguard of the modern Law of Obligations and expresses in a better way the new perspectives on the all-inclusive character of the contractual relationship.

Additionally, this vision is hugely applied in the lex mercatoria, e.g., article 1:301 (4) and the official comment to article 8:101 PECL specifically state that the violation of an accessory duty, or failure to fulfil the duty to cooperate in order to give full effect to the contract, is covered by the term ‘non-performance’.

**2.4.3 CONCLUSION: COMPARATIVE PERSPECTIVE**

In the French and in the German systems it is possible to appreciate an evolution of the concept of good faith as enshrined in the Codes. The reach of the concept has expanded in both systems and, most importantly, they are moving in the same direction in the understanding of the principle as collaboration between parties.

In France, despite the embracement of article 1134, there was an initial hesitant approach towards good faith due to the attempt of jurists to put it on too high a moral plane. In the 1930s voices were raised in favour of a major

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141 These norms refer to supplementary obligations that not affect the performance of the main duty. The infringement of ancillary duties directly affecting the performance is covered by sections 280 (3) and 281 BGB.
142 Wieacker (n 17) 97.
143 Cf. Zimmermann (n 79) 55.
role of good faith, for example, as a tool for judges to adjust contracts to unforeseen events.\textsuperscript{144} Nowadays, the obligation is under the influence of the theory of solidarism, which seeks to adapt relations that are not equal, requiring the parties’ full collaboration.

Moreover, in Germany good faith had an enormous development on the basis of §242 BGB. The most notable manifestations of this development are the embracement of the clause \textit{rebus sic stantibus} (the principle of the collapse of the underlying basis of the transactions or \textit{Wegfall der Geschäftsgrundlage}) and ancillary duties emanating from good faith.\textsuperscript{145} These manifestations accentuate the cooperative character that good faith imprints on the contract.

\section*{2.5 GOOD FAITH IN COMMON LAW}

\subsection*{2.5.1 GOOD FAITH IN THE UNITED STATES}

The Uniform Commercial Code (UCC), keystone of the commercial contract law in the US, recognizes good faith.\textsuperscript{146} This instrument contains a general reference to good faith in what was Section 1-203.\textsuperscript{147} A kind of official acknowledgement of good faith came with the promulgation in 1981 of the Restatement (Second) of Contracts,\textsuperscript{148} which in §205 provides:

\begin{quote}
This can be attributed to the change of moralists’ view in the area of justice at that time. The interest of moralists was formerly confined chiefly to problems of individual right. But during that period they concentrated on obligations that were collective and social in nature. See E Lévy, \textit{La Vision Socialiste du Droit} (M Giard, Paris, 1926); and Lévy, \textit{Les Fondements du Droit} (Nouvelle Édition, Paris 1933).
\end{quote}

\begin{quote}
\textsuperscript{147} In the sixties the UCC was adopted by the fifty legislatures of the American states. See a contemporaneous (to the adoption) critical approach to good faith in this instrument in: H Orrin, ‘Good Faith under the Uniform Commercial Code’ (1961-1962) 23 U.Pitt.L.Rev. 754.
\textsuperscript{148} The standard doctrinal formulation of good faith performance duty was first articulated in 1933 by the New York Court of Appeals in \textit{Kirke La Shelle Co. v Paul Armstrong Co}. 263 N.Y. 79, 188 N.E. 163 (1933). A restatement represents an attempt by the American Law Institute, a private organization of scholars, judges and practitioners, to formulate with some precision the leading rules and principles in major fields of American law, “in the aggregate”, so to speak, as if the United States consisted of only one, rather than fifty, state jurisdictions. R Summers, ‘The Conceptualisation of Good Faith in American Contract Law: a General Account’ in Zimmermann and Whittaker (n 12) 119-20.
Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.

The most relevant provisions on good faith in the UCC are the aforementioned Section 1-203 which is today’s Section 1-304:

Every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement.

It is worthwhile to make clear that, according to the official commentary of the UCC, ‘This section does not support an independent course of action for failure to perform or enforce in good faith’. The good faith principle directs a court towards interpreting the contract according to its circumstances.

Section 1-201 defines good faith as:

Honesty in fact and the observance of reasonable commercial standards of fair dealing.

This definition applies to the whole UCC, except Section 5 regarding letters of credit, which in article 5-107 (7) defines good faith as:

Honesty in fact in the conduct or transaction concerned.

Section 2-103 is specifically applicable to merchants in sales:

Good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing.

The term ‘honesty in fact’ may seem to imply a subjective approach of good faith, but it has more a normative or objective meaning because of the
addition of the observance of reasonable commercial standards of fair dealing.\textsuperscript{149}

Against this view, Stankiewicz, who in his ‘Good Faith Obligation in the Uniform Commercial Code: Problems in Determining its Meaning and Evaluating its Effect’\textsuperscript{150} concludes, ‘This writer suggests that the courts have so far only dealt with one, viz., the canon law view of good faith as a morally based concept’.\textsuperscript{151} The author argues this based on the personal or subjective approach given to good faith by judges.

\textit{Prima facie}, it appears quite clear to scholars coming from both the civil and the common law traditions what the difference is between objective and subjective good faith. The first makes reference to a measurable behaviour of ‘reasonableness’ between parties, whereas the second corresponds to the belief of acting honestly or rightly. It is also understood that just the first type of good faith is applicable in contracts as a general principle. In spite of this, Farnsworth draws attention to the fallibility of the common view that there is such a clear distinction. He makes the point in the following example:

Suppose you are a publisher and I am a printer and we make a contract under which I am to print some books for you and you are to take them and pay me if you are ‘satisfied’ with my printing. The contract gives you some discretion in deciding whether you are ‘satisfied’. You have to exercise that discretion in good faith. But is the test of your good faith objective or purely subjective?\textsuperscript{152}

This is a matter of interpretation, concludes the author:

What does ‘satisfied’ mean? A court would probably decide that, because it is not so difficult to judge the quality of printing, the test should be objective. If a jury decides that you ought reasonably to have been satisfied, the court will hold that you have broken our contract even if you were honestly not satisfied.\textsuperscript{153}

\textsuperscript{150} (1972-1973) 7 Val.U.L.Rev. 389.
\textsuperscript{151} Ibid 412.
\textsuperscript{152} A Farnsworth, \textit{The Concept of Good Faith in American Law} (Centro di Studi e Ricerche di Diritto Comparato e Straniero. Saggi, Conferenze e Seminari, Roma 1993) 6.
\textsuperscript{153} Ibid.
It seems that this problem does not arise if the case is regulated under the UCC, since sections 1-201 and 2-103 provide for the observance of reasonable commercial standards of fair dealing in the trade, allowing the courts to consider the testimony of witnesses familiar with the behaviour of others in the trade. Thus, an objective criterion can be applied.

The following is an example of what good faith as a commercial pattern of custom is: A expects that B will render payment at the conclusion of his work; B knows that he must render payment at this time because that is how C, D, E, F and G operate.\textsuperscript{154}

Section 1-302 allows variation of the provisions of the UCC by contract, but not of the obligations of good faith, diligence, reasonableness and care prescribed by it. However, the parties may set the standards by which the performance of these obligations is to be measured if such standards are not manifestly unreasonable. This shows that the concept is not completely mandatory.

Several articles of the UCC and of the Restatement (Second) of Contracts refer expressly to good faith. Furthermore, it is postulated that good faith and fairness have permeated the private law of the United States beyond specific cases enshrined in provisions of these regulations. According to Gordley, good faith’s influence would have even reached the classical doctrine of consideration. He states that the doctrine seems to have lost its identity, since the role that it \textit{de facto} fulfilled, policing the fairness of the agreement, is nowadays plainly concretized, taking into account the good faith of the agreements. An example will clarify the statement:

One party agrees to sell all he makes or to buy all he needs of a particular commodity from the other at a fixed price. If there are no limits to how much one party could force the other to buy from or to sell to him, the arrangement is seriously unfair. Courts used the doctrine of consideration to invalidate such contracts on the grounds that a party who binds himself to sell or buy as much as he pleases does not really bind himself. The doctrine was a crude tool for preventing unfairness. Consequently, Uniform Commercial Code replaced the common law with a more sophisticated solution: the output or requirements in question must be those that ‘occur in good

\textsuperscript{154} In agreement with this position: A Farnsworth, ‘Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code’ (1963) 30 U.Chi.L.Rev. 666.
faith' and 'no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded' (Uniform Commercial Code §2-306 (1)).

It is considered here that there is no other alternative than to support Gordley’s position, since many of the contracts in which good faith performance is of central importance once would have been unenforceable for indefiniteness or lack of mutuality.

Steven Burton unveils a gap in the literature and in judicial decisions given from the time of the introduction of the UCC. He affirms that neither courts nor commentators have articulated an operational standard that distinguishes good faith performance from bad faith performance.

Burton reflects on the expectation interest, which is usually associated with the promisee’s expectation of receiving the promised benefit of the contract (property, services or money). He argues that it also encompasses the expected costs of the promisor, which consist in the opportunities foregone at the time of contract formation. This cost perspective allows identifying a standard of good faith performance. This theory is applicable to the duty to perform in good faith when one party exercises discretion in performance and thereby controls the other party’s anticipated benefits. There would be bad faith if the party uses such discretion to recapture foregone opportunities.

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155 J Gordley, An American Perspective on the Unidroit Principles (Centro di Studi e Ricerche di Diritto Comparato e Straniero, Roma 1996) 3. In Rodney Griffith and Carla Griffith v Clear Lakes Trout Co 146 Idaho 613; 200 P.3d 1162; 2009 Ida. LEXIS 13 (2009), the Supreme Court of Idaho declared that the parties entered into an output/requirements contract, since the quantity of fish under the agreement was not only subject to the Griffiths’ good faith output of market size trout, up to the stated maximum of two million pounds, but was also subject to Clear Lakes’s good faith requirements for trout in its resale market. Interestingly, the judgement quoted the language from comment 2 to Section 2-306 of the UCC: ‘Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure’.


157 See this thesis applied to the judge’s legal duty to uphold the law in S J Burton, Judging in Good Faith (CUP, Cambridge 1992). In brief, the good faith thesis claims that judges are under a legal duty in all cases to exercise discretion on the basis of reasons provided by the
Burton states that there are two potential justifications of the good faith performance doctrine – a legal and an economic one. From the legal point of view, by requiring a party who acts in bad faith – namely, by recapturing foregone opportunities – to compensate the other party, this increases the reliability of flexible contracts and, therefore, ensures the security of such transactions. From the economic point of view, the doctrine of good faith performance would enhance economic efficiency by reducing the costs of contracting:

The costs of exchange include the costs of gathering information with which to choose one's contract partners, negotiating and drafting contracts, and risk taking with respect to the future. The good faith performance doctrine reduces all three kinds of costs by allowing parties to rely on the law in place of incurring some of these costs.

This theory is altogether acceptable. However, it suffers from two flaws. Firstly, it does not offer a positive standard to identify good faith; it only offers an excluder notion. Secondly, because the duty to perform in good faith is also applicable when all the terms of the contract are previously established and, therefore, no party exercises discretion, an operational standard to qualify as good faith in those cases still lacking.

Summers is widely known for his ‘excluder’ notion of good faith, which, in brief, implies that this principle lacks content on its own and serves just to identify situations of bad faith. The author states that, ‘Once the relevant form of bad faith is thus identified, the lawyer can, if he wishes, assign a specific meaning to good faith by formulating an “opposite” for the species of bad faith being ruled out’. This ‘excluder’ notion of good faith is encompassed in the official comment of the aforementioned §205 of the Restatement (Second) of Contracts:

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158 Burton (n 156) 392.
159 Burton (n 156) 393.
160 Summers (n 148) 125.
The phrase good faith is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving ‘bad faith’ because they violate community standards of decency, fairness and reasonableness. 161

In addition, some types of bad faith mentioned here have been recognized by judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, wilful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party’s performance. 162

It is difficult to agree with the thesis of Summers which deprives good faith of any core concept. According to Summers’s view, good faith can only be understood by reference to what courts have in the past considered bad faith. One would be forced with this restrictive interpretation to conclude that good faith means what the courts say it means.

Farnsworth considers the following relevant norms of the Uniform Commercial Code to show his view on the subject: § 2-305 Open Price Term, which states, ‘A price to be fixed by the seller or by the buyer means a price to be fixed in good faith’; § 2-306 Output, Requirements and Exclusive Dealings (previously analyzed); 163 and §2-603: Merchant Buyer’s Duties as to Rightfully Rejected Goods, which, in short, states that if the merchant buyer is left in possession of goods that he has rightfully rejected, his obligation to effect salvage under the Code is one of good faith. 164 Here the references are to

163 See n 155 and the text that accompanies it.
164 The text of §2-603 is as follows: ‘(1) Subject to any security interest in the buyer (subsection (3) of Section 2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the
objective good faith (in opposition to good faith purchase, which is purely subjective) and the standards to refer to are decency, fairness or reasonableness in performance or enforcement.

According to Farnsworth, where good faith is necessary in order that the other might secure the expected benefits of the contract, it ‘represents a specific application of the general obligation of good faith – resulting in an implied term of the contract requiring cooperation on the part of one party to the contract so that another party will not be deprived of his reasonable expectations’ (emphasis added).\(^{165}\)

Apart from the most well-known theories, there are others proposals seeking to explain the meaning of good faith in the UCC.

Gergen proposes a theory based on efficiency. He argues that the hypothetical parties at the contracting table – confronted with hypothetical and unexpected events – would agree to limit their discretion to make efficient changes. In other words, ‘neither contracting party would expect either party to exercise discretion in a way that would not be efficient, \(i.e.,\) in a way that would inflict a greater injury to the other party than the gain to himself’.\(^{166}\)

White is sceptical regarding this theory. He states: ‘Who is to say that a cooperative antagonist will remain cooperative when discretion is unexpectedly given to it? In a world occupied by cooperative antagonists, I doubt that Professor Gergen’s hypothesis about expectations is true to life’.\(^{167}\)

How can one resolve this disagreement?

Raiffa’s theory is an option. First of all, he poses the question, ‘What norms of behaviour do you expect of the others in your negotiation discussions?’ As a way to answer, he aptly distinguishes those who might

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166 The idea is to be found in J J White, ‘Good Faith and the Cooperative Antagonist’ (2001) 54 S.M.U.L. Rev. 679, 689.
167 Ibid 690.
sign business contracts from others, from the strident antagonist (malevolent, untrustworthy) and from the fully cooperative partners (completely open to one another, totally honest, fully disclosing and not strategically posturing). He states that, ‘Cooperative antagonists recognize that they have differences of interests’. Once one is well aware about the distinction between a cooperative antagonist and a fully cooperative partner, the logical question is, how does the cooperation between traders become effective? It may be that the answer lies in the expectations of the parties when contracting. What a party can expect during the different phases of the contract is that the other party will do what the reality requires to attain the aim of the contract. During the fulfilment the antagonist’s interest is directed towards that aim, but it is not suppressed.

2.5.2 GOOD FAITH IN ENGLISH LAW

The traditional view is that English law is far from the overarching principle of good faith in contractual dealings. English case law offers an example of the absence of the concept of good faith as a general one: in Banque Financière de la Cité SA v Westgate Insurance Co Ltd Lord J Slade stated:

The law cannot police the fairness of every commercial contract by reference to moral principles. It frequently appears with hindsight that one contracting party had knowledge of facts which, if communicated to the other party, would have protected him from loss. However, subject to well-recognised exceptions, the law does not and

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169 Ebke and Griffin state a similar theory, but only for the case of lending contracts: ‘The covenant of good faith requires the co-operation of one party to the lending agreement where it is necessary in order that the other party might secure the expected benefit of the bargain. In the performance of a commercial lending transaction or the enforcement of a right arising out of a loan agreement, a party who evades “the spirit of the agreement” and so denies the other the benefits of the bargain commits a breach even if the evasive conduct is within the letter of the agreement’. W Ebke and J Griffin, ‘Good Faith and Fair Dealing in Commercial Lending Transactions: From Covenant to Duty and Beyond’ (1988-1989) 49 Ohio St.L.J. 1237, 1239.
should not undertake the reopening of commercial transactions in order to adjust such losses.\(^{170}\)

The natural question is why good faith has not been embraced as a general principle in English law?

**First theory: Weakness of English Law Merchant**

The lex mercatoria was absorbed into the law of England by Lord Mansfield in the eighteenth century.\(^{171}\) However, good faith, the essential principle of the lex mercatoria, was not embraced. This is due to the lack of development of the law merchant in the merchant courts of England. The lack of development of the merchant courts is usually attributed to the strength of the common law courts, which, in fact, took priority over the former.\(^{172}\) Stuart Sutherland adds other reasons for the lack of development of the merchant courts in England – while they were increasing in strength elsewhere. The first reason is the growth of the Admiralty Court, which rose to the height of its importance in the sixteenth century. The other cause of the failure of the law merchant to develop in the merchant courts was the division between traders and merchants, ‘The merchant was to the English essentially the exporter, with his organised market abroad. For this reason an English centre of exchange was slow to develop, and when it did was only a small offshoot of the great exchange market abroad’.\(^{173}\)

Furthermore, according to Farnsworth, in the eighteenth century – when the law merchant had been absorbed into the common law – the kind of good faith that found its way in commercial matters in the King’s courts was a

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\(^{171}\) It is beyond the scope of the present thesis to reassess this process, which may be checked in: J Oldham, *English Common Law in the Age of Mansfield* (University of North Carolina Press, Chapel Hill 2004). The previous stage of co-existence of the law merchant and the common law may be illuminated by J H Baker’s work: ‘The Law Merchant and the Common Law Before 1700’ (1979) 38 CLJ 295. Baker suggests that the distinction between the lex mercatoria and the law of the Kingdom of England was only procedural. He also argues that the common law courts did not ‘incorporate’ the law merchant, but they operated a process of ‘refinement’ of the common law ‘which had always governed mercantile affairs’ (p. 322).

\(^{172}\) Cf. Baker (n 171) 306.

subjective good faith or the belief of acting honestly or rightly. This was because the courts were concentrated upon the development of a body of doctrine to encourage the free circulation of goods and commercial documents. Thus, good faith purchase, not good faith performance (as a standard of behaviour), was the concern in those days. 174

- Second theory: The Formation of the Doctrine of Consideration

Renowned studies reveal the influence that canon law and civil law exerted upon legal ideas in all the nascent states of Western Europe in the Middle Ages. 175 This influence was also felt in England. Holdsworth points out that during the twelfth and thirteenth centuries, ‘the influence of civil and canon law is perhaps the most important of all the external influences which have shaped the development of English law’. 176 However, the principle of good faith was not embraced as a general one in English law.

The clerical canon lawyers of the twelfth and thirteenth centuries introduced the Roman canon law concept of conscience in England. 177 Even during the fourteenth century ‘conscience’ was referred to and it was made the basis of an occasional decision. 178 Holdsworth argues in favour of the influence of this notion over the shape of the Chancery courts. 179 The same

174 ‘The leading cases involved the test of good faith for a holder in due course of a negotiable instrument. In 1801, in Lawson v Weston, Lord Kenyon ruled that the holder need not make diligent enquiry when he takes the instrument, and – with the grim prediction that to require such an enquiry ‘would be at once to paralyze the circulation of all the paper in the country’ – he introduced the subjective test of actual good faith, the test of ‘the pure heart and empty head’. In 1824, in Gill v Cubitt, the subjective test was discarded for an objective test that required the holder to exercise the prudence and caution of a reasonable man. But in 1836 Gill v Cubitt had been overruled in England’. Farnsworth (n 154) 670.


176 Holdsworth Vol. II (n 175) 146. Specifically, the canonical influence on English civil procedure is stressed by H D Hazelline, Roman and Canon Law in the Middle Ages. The Cambridge Medieval History Vol. 5 (CUP, Cambridge 1964) 756 ff.


178 Holdsworth Vol. II (n 175) 344 and 346.

179 Holdsworth Vol. II (n 175) 346. The growth of a separate and distinct court of Chancery took place in the latter part of the fifteenth century and then in the sixteenth.
author states that equity was also administered by the common law courts.\textsuperscript{180} However, in the latter half of the fourteenth century and then in the fifteenth century the common law tended to become a fixed and rigid system due to the lack of connection with the king – the royal discretion was at the basis of the equitable modification of the law. This rigidity determined the development of a set of equitable principles and ideas outside the common law and mainly administered by ecclesiastical chancellors.

What was the theory of contract held by the ecclesiastical lawyers?

The question can be answered by examining the nature of the test which they applied to identify a binding agreement. The canonists of that period emphasised the binding character of consent which imposed an imperative duty in conscience and good faith. An obligation, they said, is derived \textit{non ex nuda sed ex sola promissione}.\textsuperscript{181} The canonists propounded the doctrine of \textit{pacta sunt servanda} by which simple naked agreements and promises should be binding.\textsuperscript{182} To obtain recognition of such agreements canonists moved to the proposition that a naked pact was valid if it was ‘clothed’ by an adequate \textit{causa} – the ancestor of the continental \textit{causa}.

What was the theory of contract held by the medieval chancellors?

Barbour says that probably the test applied to distinguish agreement from contract was the canonist idea of \textit{causa}.\textsuperscript{183} The chancellors concluded that an agreement, because it was an agreement, ought to be enforced. This rose as a corrective to the rigidity of the common law and influenced it to

\textsuperscript{180} W S Holdsworth, ‘The Early History of Equity’ (1915) 13 Mich.L.Rev. 293. He cites a number of authoritative studies to base his position at p. 294.

\textsuperscript{181} Good faith influenced in the same way the law merchant. Here, Mitchell in: \textit{An Essay on the Early History of the Law Merchant} (CUP, Cambridge 1904) 102 and 105 states: ‘Slowly it (good faith) undermined the Roman and Germanic principle that in general formless contracts are not binding … It is quite clear that in the fourteenth century the validity of the \textit{nuda pacta} in commercial transactions was recognised in Italy by mercantile usage, and it seems probable that in commercial and local courts they were recognized in England’ (parenthesis added).


extend the sphere of *assumpsit* (an action to recover damages for breach of
an express or implied contract or agreement that was not under seal).

For the sake of relations of confidence the notion of *causa* of the
canonists was accepted by common law courts to give validity to *parol*
agreement.

Yet, it was called ‘consideration’. It had not that moral meaning
of the canon law (‘let the Church manage that, if it can’),
but it was based
on a charge on the other party. There was, therefore, a difference between
these two concepts – *causa* and consideration – in the suits for breach of
contract brought to the church courts (*fidei laesio*) and to the royal courts
(*assumpsit*).

It is considered here that this differentiation – between the objective
concept of consideration adopted by the common law courts and the original
duty in conscience of the canon law – lies at the basis of the non-existence of
good faith as an overarching principle in the common law of England.

However, it is still possible to find some references to good faith in
specific contracts in English law nowadays:

- **Sales of Goods Act 1979** contains general references to good faith in
different sections, such as section 61:

  A thing is deemed to be done in good faith within the meaning of this
  Act when it is in fact done honestly, whether it is done negligently or
  not.

  Another example is section 23 Sale under Voidable Title:

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184 A primary obligation of conscience and good faith – that agreements must be observed – became the foundation of liability in English law with the development of *assumpsit*, which became a remedy upon all *parol* agreements. See J B Ames, ‘Parol Contracts prior to *Assumpsit*’, (1894-1895) 8 Harv.L.Rev. 252.


186 Holdsworth (n 180) 301 states that, ‘From this point of view the ideas drawn from the canon law and the practice of the ecclesiastical Chancellors were the greatest of the forces which inspired the common lawyers to create the most distinctive of all the features of the English law of contracts – the doctrine of consideration’.

When the seller of goods has a voidable title to them, but his title has not been avoided at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller’s defect of title.

In these precepts the reference is to a form of good faith ‘honesty’ or subjective good faith. This is explained by the matter regulated in the Act, since subjective good faith is associated with *iura in re*, specifically possession, in which there is the acknowledgement of acting rightly or not being damaging to the rights of others. By contrast, objective good faith is placed in the ambit of contracts; it means a measurable behaviour of ‘reasonableness’ between the parties.\(^{188}\)

As regards this differentiation, Dalhuisen holds:

The use of good faith notions in contract law signals a quest for more objective criteria to determine parties’ rights and duties, and as such it presents a challenge to the nineteenth century will theory and to the notion of each party’s psychological intent. Even if stronger in interpersonal relationships, it favours depersonalisation of contract law and limits the traditional anthropomorphic idea of contract.\(^{189}\)

The phenomenon described by Dalhuisen, *i.e.*, the depersonalisation of contracts, makes evident the necessity for an objective criterion of good faith – measurable beyond the intent of the persons behind a contractual relationship. Hence, the lex mercatoria embraces the objective concept of good faith cooperation, as will be seen.

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\(^{188}\) This objective aspect of good faith starts to be clarified at the end of the nineteenth century, although the objective concept of good faith was not extraneous to philosophical European thought. The doctrine of Vico, for example, contains good faith with an objective profile in the essay *De universi juris uno principio, et fine uno* (1720). Examining jusnaturalist theories, he identifies the *societas veri* (society of truth) and *societas aequi boni* (society of equal utility) and observes that the first proposes a number of obligations that imposes the duty to conclude and perform agreements with honesty. The motto of this society is ‘Let us act in good faith’ (*bona fide agito*). However, in the second type of society, *societas aequi boni*, Vico insists on the criterion *neminem laedere* and the virtue of diligence in the agreements *inter privatos*. Cfr. J B Vici, *De Universi Juris Uno Principio, et Fine Uno* (Neapolis 1720) 28; cfr. also the translation from Latin into English in G Vico, *Universal Right* (Rodopi, Amsterdam 2000) 187-8.

\(^{189}\) Dalhuisen (n 68) 288.
The following examples contain a more objective form of good faith:

- **Directive on Unfair Terms in Consumer Contracts** has been in force in English law since 1995. The Directive contains norms as article 3, which states:

  A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith.

  *Prima facie,* this could be considered a revolution in the traditional approach to good faith in English law. Steyn, however, thinks differently. He mentions the Unfair Consumer Terms Act of 1977 as an example of how the English legislature had set statutory standards of fair dealing before the Directive.

  Collins argues that the Directive is not essentially concerned with the fairness of the contract between the parties:

  It has grander ambitions, which fit into the aspirations of the social market of the EC. In seeking to establish the necessary conditions under which citizens have access through markets to high quality goods and services at competitive prices, the legislators of the Community have recognized that a market which permits antagonistic individuals to pursue their own best interests is likely in the end to frustrate their aspirations by generating many market failures … A successful market

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190 The Directive was implemented in the UK via the Unfair Terms in Consumer Contracts Regulations 1994, which came into force on 1 July 1995. The Regulations of 1994 have been replaced with the Unfair Terms Consumer Contracts Regulations 1999, Statutory Instrument 1999 N. 2083. The relevant provision of the Directive which requires the member States to adopt their systems according to the new normative is article 10. It reads:

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive no later than 31 December 1994. They shall forthwith inform the Commission thereof.

2. When Member States adopt these measures, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such a reference shall be laid down by the Member States.

3. Member States shall communicate the main provisions of national law which they adopt in the field covered by this Directive to the Commission.

191 Steyn (n 187).
system requires the recognition of such bonds of solidarity between the parties to contracts. And this has been expressed as a requirement of good faith.\textsuperscript{192}

Nonetheless, according to Collins, the Directive poses a challenge to purely self-interested rationality which often is identified as the guiding value of the common law of contracts.

This Directive meant the fulfilment of what Steyn predicted about the increasing importance of good faith in consumer law, by way of the influence of European legislation.\textsuperscript{193}

A judicial decision which clarified the meaning of ‘good faith’ for the purposes of these Regulations is Director General of Fair Trading v First National Bank plc.\textsuperscript{194} The judgment of the Court of Appeal is particularly enlightening regarding the notion of good faith; it states that this is to be equated with open and fair dealing and has a procedural and substantive element. The procedural aspect implies an obligation to consider consumers’ interests;\textsuperscript{195} according to the substantive aspect a clause is not always against good faith, but it can be upheld if it is brought to the attention of the consumer.\textsuperscript{196}

This decision reveals that the fairness in the Act is a matter of cooperation between the parties, which is not a novelty in the English system of law. It is just more limited than in civil law systems. Common sense indicates – at the least in commercial contracts – that, ‘every business contract depends for its smooth working on co-operation. But in the ordinary business contract, and apart, of course, from express terms, the law can enforce co-operation only in a limited degree – to the extent that is necessary

\textsuperscript{193} Steyn (n 187).
\textsuperscript{194} (2000) 2 WLR 1353 (CA)
\textsuperscript{195} Regarding this idea Collins states, ‘And the assimilation of social values embodied in the law suggests that the common law of contract, which Kahn-Freund once described aptly as ‘designed for a nation of shopkeepers’ will eventually have to succumb to a more communitarian ideal which balances the interests of consumers against those of shopkeepers’. Collins (n 192) 254. The author quotes from: O Kahn-Freund, C Lévy, B Rudden, \textit{A Source-Book on French Law} (OUP, Oxford 1973) 286.
\textsuperscript{196} See H Beale, ‘Legislative Control of Fairness: The Directive on Unfair Terms in Consumer Contracts’ in Beatson and Friedmann (n 92) 245.
to make the contract workable’. In legal systems where good faith is fully recognized as a general principle, cooperation can be derived from this general clause. But that is not the case in English law. Therefore, it is important to identify case by case the existence of this necessity of cooperation. Such a duty in English law will normally be pleaded as an implied term of the contract, i.e., derived from the parties’ will. The establishment of a general principle of good faith would enable the identification and solution of problems without forcing the concept of implied terms.


The main innovations that this Directive brought into the common law are twofold: first, it introduced the categorization of commercial agents – which did not exist in common law –; second, the type of control it introduced was completely new.

Regarding the introduction of a new category, the commercial agent is defined in regulation 2 (1) as ‘A self-employed intermediary who has continuing authority to negotiate the sale or purchase of goods on behalf of

197 This is Justice Devlin’s reasoning in: Mona Oil Equipment and Supply Company Ltd. v Rhodesia Railways Ltd. (1949-50) 83 Lloyd’s Rep. 178, 187. This case was based on a contract of supply of 75 oil tanks and the condition for the payment of the price was renegotiated during the life of the contract. The price was not paid finally and the judge was called to pronounce his decision on whether this was a breach. The judge solved the case on the basis of the level of cooperation shown by the defendant for the fulfilment of the condition that had effected the payment of the price. Here, it was considered that a sufficient degree of cooperation was shown (this would have been called good faith in a civil law country): the defendant had to ‘instruct’ its agents in London to ascertain whether the tanks were at the disposal of the defendant. It was not required to the defendant to ‘procure’ them to act.


another person (the ‘principal’), or to negotiate and conclude the sale or purchase of goods on behalf of and in the name of that principal’.

As regards the second innovation, in common law the traditional view was that the principal needed protection against misuse of the agent’s powers; therefore, fiduciary duties of the agent developed. The Directive, instead, is based on the civil law assumption that commercial agents are the weaker party in the relationship. Hence, the Regulations are meant to afford protection to the agents against the principals.

The Regulations do not require fiduciary duties, albeit they contain duties of good faith concerning the agent and the principal. The Regulations require of the former that:

3 (1) In performing his activities a commercial agent must look after the interests of his principal and act dutifully and in good faith.

Importantly, according to the Agency Regulations the principal is also required to act in good faith in his relations with the agent:

4 (1) In his relations with his commercial agent a principal must act dutifully and in good faith.

(2) In particular, a principal must
(a) provide his commercial agent with the necessary documentation relating to the goods concerned;
(b) obtain for his commercial agent the information necessary for the performance of the agency contract, and in particular notify his

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200 Agency has been defined as: ‘the fiduciary relationship which exists between two persons, one of whom expressly or impliedly consents that the other should act on his behalf so as to affect his relationship with third parties, and the other of whom similarly consents so to act or so acts’. F M B Reynolds, Bowstead and Reynolds on Agency (16th edn Sweet & Maxwell London 1996) §1-001. The strictness of the English rules on the agent springs from the strictness originally required by Courts of Equity in cases where the fiduciary relationship exists. See Armstrong v Jackson [1917] 2KB 822.

201 Saintier in ‘A Remarkable Understanding and Application of the Protective Stance of the Agency Regulations by the English Courts’ [2001] JBL 540, 547 n 7, states that ‘Civil law recognises the risk that once commercial agents have created or developed the customer base, manufacturers might terminate the contract, by-pass commercial agents and deal directly with the clients, which would deny commercial agents their legitimate share of the profit’.

202 See Preamble to the Regulations.
commercial agent within a reasonable period once he anticipates that
the volume of commercial transactions will be significantly lower than
that which the commercial agent could normally have expected.

(3) A principal shall, in addition, inform his commercial agent within a
reasonable period of his acceptance or refusal of, and of any non-
execution by him of, a commercial transaction which the commercial
agent has procured for him.

Regulation 4 of the Regulations generally involves a duty to cooperate
and this, therefore, represents a significant change from the traditional
common law rules, which imposed no implied duties on the principal.203

Saintier explains that the silence of the text of the Directive as regards
the meaning given to the duty of good faith is regrettable, since it raises doubt
as to the likely impact of good faith as a key principle of this regulation. This
could affect the harmonization of law between member states. The author
finds elements to illustrate this duty in the French legal tradition:

Good faith/co-operation requires a more active stance from the parties. It requires, for
instance, the promisor to refrain from acting in a way which would jeopardise the
promisee’s interests. It requires that the promisee must provide the services best
suited to the promisor’s particular interests. This is clear with the obligation of
information, i.e. the obligation to mention to the other party any events, which s/he
has an interest in knowing for the performance of the contract.204

Despite the silence on the meaning of good faith, parties have invoked
the principle205 and English Courts have applied it in this context. For
example, in the case Graham Page v Combined Shipping and Trading Ltd.206
the court – in an interlocutory matter – granted the injunction on the ground
that ‘proper performance’ of the contract under regulation 17 (7) (a) could be

203 See S Saintier, Commercial Agency Law. A Comparative Analysis (Ashgate, Aldershot
2002) 123.
204 Eadem
205 There are a number of recent cases in which good faith has been invoked: Barnett Fashion
Agency Ltd. v Nigel Hall Menswear Ltd. [2011] EWHC 978 (QB); Gledhill v Bentley Designs
206 [1997] 3 All ER 656. In this area, this is the first time an English court has referred to and
applied the civil-law-based duty of good faith in its reasoning.
interpreted as meaning ‘normal performance’, i.e., performance in the normal manner in which the parties intended the contract to be performed rather than performance in accordance with the contract terms. To reach such a conclusion the court used the duty of good faith enshrined in regulation 4 (1).

There are no doubts that the Directive and the Regulations introduced good faith into the English scene and that, as part of this regulation, good faith amplified the spectrum of duties of the principal towards the commercial agent. What does this incorporation mean?

From a negative point of view, good faith has already been seen as a duty, meaning to protect one party – the agent. Markesinis, for example, points out that the EC Directive conferred upon the agents and their principals a legal regime which likens them more to employees than to the independent commercial traders which in reality they are.207 Good faith does appear in these Regulations as having a paternalistic feature close to the role of the principle in consumer and employment law.

However, from a positive perspective, the Regulations require an objective evaluation of the conduct of the parties. This is in line with the current meaning given to the principle in national and transnational commercial law. Good faith is applied in the sense of cooperation, which implies the exigency of the parties to look after each other’s interests. This also requires them to disclose the necessary information which is relevant for their respective obligations.208 Here, Saintier states that, ‘the principal is also required to act in good faith in his relations with the agent. This generally involves a duty to co-operate and this therefore represents a significant change from the traditional common law rules, which imposed no implied duties on him/her’.209

208 Saintier states that English and Scottish courts have succeeded in defining the scope of application of the Regulations and protecting commercial agents: ‘In fact, not only have they applied the Agency Regulations with relative ease but they also have ensured their effectiveness by emphasising their civil law inspired protective stance with a remarkable understanding. Such an understanding was not expected and is very welcome since, to a certain extent, it balances out some of the drawbacks created by (almost) replicating the Directive’. Saintier (n 201) 541
209 Saintier (n 203) 63.
Good Faith in Insurance Contracts in English law

Historically the rules regarding contracts of insurance have in general developed through judicial decisions, i.e., the common law. However, over the years these contracts have been the object of numerous specific regulations. The most renowned example – since it has been considered the general ‘codification’ for ‘insurance law’ in English common law – is the Marine Insurance Act of 1906. Other examples are life insurance\(^\text{210}\) and other types of insurances which are compulsory.\(^\text{211}\)

Consumer insurance contracts have been affected by domestic and European regulations related to consumer contracts\(^\text{212}\) and, currently, there is the strong possibility of the reform of insurance law promoted by the Law Commission.\(^\text{213}\)

It is well-known that from the pronouncement of Lord Mansfield in *Carter v Boehm*\(^\text{214}\) in 1766 good faith has been present in insurance contracts. It is also embraced in section 17 of the Marine Insurance Act of 1906 in the following terms:

A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

The obligation of utmost good faith concerns both parties, the insured and the underwriter. The scope of this norm has aroused fervent debate, because it is argued that this obligation has no consequences for bad faith’s

\(^{210}\) Life Insurance Act 1774.  
\(^{211}\) Compulsory insurances are, for example, the motor vehicle insurance regulated by the Road Traffic Act 1988, ss. 143 and 145. See other compulsory insurances in J Birds, *Birds’ Modern Insurance Law* (Sweet & Maxwell, London 2007) 379 ff.  
\(^{212}\) Unfair Terms in Consumer Contracts Regulations 1999 and Contracts (Rights of Third Parties) Act 1999. There are also attempts to unify the subject at the level of principles; the scholarly project group ‘Restatement of European Insurance Contract Law’ elaborated the Principles of European Insurance Contract Law:  
<http://aida-portugal.org/pdf/bc18d3af669a52ac20f164d7c9681d5d.pdf>  
See also: <http://www.restatement.info/> both sites accessed 16 May 2011.  
\(^{213}\) See further details about this reform below in this sub-paragraph.  
\(^{214}\) (1766) 3 Burr 1905.
insurer, since the remedy provided – avoidance of the contract – is, in practice, ineffective for the insured. What it needs is a remedy for damages.

The theme of ‘Damages for Late Payment and the Insurer’s Duty of Good Faith’ has been proposed for discussion in the Issues Paper 6 of the Law Commission.\(^{215}\) In spite of the recognition that both parties to an insurance contract have mutual duties of good faith, in the case of either unduly refusing claims or late payment by the insurer, the insured can sue for payment of the money owed plus interest but, as has been stated, damages are not available.\(^{216}\) The verdict on *Sprung v Royal Insurance* confirms this position.\(^{217}\) This creates an injustice in fact and an open contradiction of general contract principles in the law of England and Wales\(^{218}\) – Scottish law, however, does recognize damages in this case.

The solutions proposed by the Law Commission are: to modify s. 17 of the Marine Insurance Act or; to reverse the decision in *Sprung v Royal Insurance*.

On 18 November 2010 the Law Commission published a summary of the responses received to Issues Paper 6. The Commission received 32 responses, which reveal strong support for change. Consultees emphasised that if an insurer has declined a valid claim and acted unreasonably, then insurance law ought to be brought into line with general commercial contractual principles and the policyholder should be offered an appropriate remedy. At this moment the Law Commission is developing proposals and it is due to publish a formal joint consultation paper by the end of 2011 or at the beginning of 2012.\(^{219}\)

\(^{215}\) Issues Paper 6 is retrievable at:
\(^{216}\) This is due to a fiction, by reason of which the first obligation of the insurer is ‘to hold the insured harmless’. If the loss occurs, the insurer will pay the amount of the claim as damages.
\(^{218}\) The general rule in England is that if one party breaks a contract, the other party may claim damages for the actual loss suffered, provided that it was foreseeable at the time the contract was made. This is subject to three main limitations:
1. The victim of the breach of contract must prove actual financial loss;
2. The victim must take reasonable steps to mitigate the loss;
3. The level of damages may be limited (or expanded) by the express provisions of the contract.
\(^{219}\) Statement by James Sharpe on behalf of the Law Commission (Personal email correspondence 20 July 2011). The summary of responses is available at:
On the other hand, the duty of utmost good faith of the insured has reached unexpected levels of amplitude. The criticisms arise from the key duty of disclosure, since ‘The basic legal doctrine of insurance clearly recognised that the insured can act honestly or in good faith and yet be penalised by application of the doctrine of utmost good faith’. Steyn points out that minimum non-disclosure – which potentially could have not affected the decision to take the risk if disclosed before – may entitle the insurer to avoid the contract.

However, in *Drake Insurance v Provident Insurance plc*, the view of Lord Rix is that the insurer’s duty of utmost good faith can act to limit the remedy of avoidance. In other words, the insurer’s right to avoid for non-disclosure or misrepresentation must be exercised in good faith, which implies that the insurer should not blindly rely on the avoidance without good reasons for seeking it.

In spite of this excellent analysis, Birds states that *Brotherton v Aseguradora Colseguros SA* is preferable as matter of current law. He points out that, ‘A right to avoid or rescind is not traditionally limited by any requirement of good faith and it could be argued that this is a better view of the law as it is than that seemingly expressed in *Drake v Provident*’. Butcher proposes, in an extreme position, to dispense with the concept of good faith in insurance contracts. According to him, the doctrine of good faith has developed into a series of structured rules in the area of pre-contractual disclosure in disadvantage to the assured. What Butcher proposes as a good solution for a future statute is that, without referring to good faith, a

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222 Steyn (n 187) 131.

223 [2003] EWCA Civ 1834.


226 Birds (n 211) 146.
clear determination of matters that have to be disclosed should be provided and the consequences of non-disclosure and of misstatements expressed.227

Despite the commendable aim of this proposal, it is impracticable. Lord Mansfield was not wrong when he said in *Carter v Boehm* that, ‘Insurance is a contract upon speculation’. The information that could help the insurer to assess the risk is peculiar to each case; therefore, to elaborate a list with material facts to be disclosed is impossible – although there are some material facts which by the nature of the insurance policy can be predicted as important.

Good faith is essential in insurance. If it is conceived as cooperation between the parties, it will give rise to two natural consequences: the insured will disclose the information that can help the insurer to assess the risk; the latter will use such information in a correct way, without using the remedy of avoidance in the case of a minimum non-disclosure. It is held here that this is the interpretation given to good faith by Lord Rix on *Drake Insurance*. It is interesting to note that this theory moves the attention from pre-contractual good faith to good faith in the phase of enforcement, requiring that remedies for breach become more thoughtful, focused, proportionate and flexible.

Furthermore, the obligation of disclosure based on the utmost good faith has been extended during the life of the contract, upon condition of renewal of the contract.228 Here, Lord Hobhouse confirmed that ‘utmost good faith is a principle of fair dealing which does not come to an end when the contract has been made’. The issue that this duty creates is the remedy of avoidance of the contract *ab initio*, according to section 17 of the Marine Insurance Act, which may be disproportionate in many cases.229

In the opinion of Aikens, s. 17 does not extend the duty of good faith post-contract: ‘All s.17 is doing is saying that the duty extends beyond specific ones placed on insured in ss. 18-20 and that it also places duties on the insurer as well’.230 The matter needs solution from legislation or from the

228 See the leading case of *Manifest Shipping Co Ltd v Uni Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1; (2001) 2 WLR 170.
229 See *Banque Financière de la Cité SA v Westgate Insurance Co Ltd* [1991] 2 AC 249 (HL).
Supreme Court. Aikens states that, ‘It would be a bold Supreme Court that introduced now a right to damages for breach of that duty’. 231

Moreover, on 9th July 2010 the Law Commission opened a consultation on the issue of the insured’s post-contract duty of good faith in Issues Paper 7. 232 The main aspect considered is the duty of good faith at the moment of making a claim and, consequently, what remedy would be available to insurers if policyholders act fraudulently.

The courts have been keen to punish the fraud of the insured with the forfeiture of the claim – and not with the avoidance of the contract. The Law Commissioners support this position as follows:

Thus if a policyholder suffers £18,000 of legitimate loss, but then adds a fictitious claim of £2,000 for an item which never existed, the policyholder loses the whole £20,000 claim. We think this is right. Policyholders should not be able to add invented items to claims safe in the knowledge that even if the fraud is discovered they will lose nothing.

The point is whether the law should provide greater clarity on the remedies available to insurers when policyholders act fraudulently.

The Law Commission itself states in the summary of responses to the Issues Paper 7:

The law in this area is complex and confused. The duty of good faith was codified in section 17 of the Marine Insurance Act 1906, and provides insurers with the right to avoid the contract from the start. In other words, when a fraudulent claim is made, the insurer can ask the policyholder to repay all claims made under the policy, including perfectly genuine claims which were paid before the fraud arose. However, market practice has evolved and courts have navigated away from this position. Instead, courts have preferred to hold that a fraudulent policyholder forfeits the whole of the fraudulent claim, while leaving other aspects of the contract unaffected. 233

231 Ibid 392.
The Law Commission received 33 responses. The majority thought that the law was unnecessarily complex and that it would be helpful to introduce legislation to clarify the insurer’s remedy for a fraudulent claim.

Undoubtedly, fraudulent claims are a serious problem. However, it must be noted that the construction of the problem and the solution searched for by the Law Commission convey an anti-fraud message. This implies that good faith is considered here in its subjective aspect of honesty – the same as the good faith purchase previously analysed. Therefore, this is very far from the commercial concept of good faith, which is currently applied in England – as will be seen below.

Here, some authors hold that good faith in the sense of fair dealing and reasonableness already exists or, at least, that it will play an important role in English law.

Tetley holds that there is some recognition, even in judicial circles, that a general good faith principle is, after all, not totally alien or anathema to English law.

MacQueen reports leading voices in England calling for acknowledgement of the principle. Among those voices, there is McKendrick, who reasons that, in fact, English law offers little by way of comfort to those who act in bad faith or who do not honour the promises which they make. The issue would be the unwillingness of scholars and judges to recognize good faith as a general principle. McKendrick claims that this is due to their distrust regarding general principles, rather than to their reaction to good faith itself. He warns about the necessity to align with the trend to accept good faith, as has been done in transnational law and in other European

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234 For example, according to the summary of responses to Issues Paper 7 (n 226), the Association of British Insurers (ABI) noted that in 2009 insurers detected £841 million of general insurance fraud.

235 See the views against good faith by Merkin and Hodgin in the summary of responses to Issues Paper 7 (n 233).

236 This is the position of Sims (n 133). See also by the same author: ‘Good Faith in Contract Law: of Triggers and Concentric Circles’ (2005) 16 KLJ 293.

237 See Lomax (n 66) passim.


jurisdictions, in order to avoid isolation and, most importantly, in order to permit English judges to give effect to the agreement that parties have freely reached – for example, to conduct preliminary negotiations in good faith or subsequently during the life of the contract.

Generally, the parties to a contract of joint venture agree that they will endeavour by good faith efforts to resolve by mutual agreement any dispute arising in connection with their contract. This kind of clause responds to the need to preserve a degree of flexibility and cooperation in long-term contracts. McKendrick states that, if the judges in *Walford v Miles* would have considered this reality, ‘they might have been rather more ready to embrace the concept of an enforceable obligation to negotiate in good faith’.  

Goode refers also to the argument of isolation of English law:

The gradual movement towards the harmonization of commercial law in Europe, though creating additional problems for a purely national codification programme, also lends urgency to the task of restating the principles on which our own commercial law is based; and it has the additional advantage of providing an exportable product which can help to maintain, and indeed enhance, the influence of English law and English courts in international commercial transactions.

Goode recognizes that, ‘Commercial law is rooted in principles of good faith, the sanctity of the agreement, the recognition of trade usage as a source of contractual rights, and the maintenance of a fair balance between vested rights and the interests of third parties’. He advocates for a code of the kind like the UCC, restating, simplifying and modernizing the law in a small number of selected areas in order to make it more responsive to the practices and needs of modern commerce and finance while containing built-in mechanisms to allow for future development. It is noteworthy that this represents an

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242 Ibid 1203.

243 Ibid 1208.
evolution of Goode’s thought since, in 1992, the author was radically against good faith.244

In addition, Burrows identifies the existence of the principle with limitations as to the extension of the duty: it goes no further than to impose a duty to act if an express term of the contract cannot be fulfilled without that act being done. The criterion is necessity. The positive act must be ‘necessary for the business efficacy’. In his view, one party should not lightly be found to be under any unexpressed duty to help the other.245

There is every likelihood that long-term and collaborative contracts mentioned by McKendrick – for example, joint venture contracts which are marked by a high degree of loyalty and good faith – will express the living orthodoxy of tomorrow’s international commerce, because business undertakings need, more and more, partners to share in their projects.246 The reality and the argument of isolation of English law raised by Goode highlight the importance of embracing good faith as a way to harmonize English law with the practice of international commerce. This is self-evident.247

244 The author previously held: ‘The predictability of the legal outcome of a case is more important than absolute justice. It is necessary in a commercial setting that businessmen at least should know where they stand...The last thing that we want to do is to drive business away by vague concepts of fairness which make judicial decisions unpredictable, and if that means that the outcome of disputes is sometimes hard on a party we regard that as an acceptable price to pay in the interest of the great majority of business litigants’. Goode (n 82) 9.


246 An example of this participative way of doing business is the Supply Chain Management (SCM), which is the management of a network of interconnected businesses involved in the ultimate provision of products and service packages required by end customers. Incorporating SCM successfully leads to a new kind of competition in the global market, i.e., competition is no longer of the company versus company but rather takes on a supply chain versus supply chain form. See: R H Ballou, Business Logistics Management. Planning, Organizing, and Controlling the Supply Chain (Prentice Hall International, Upper Saddle River 1999). There is also a cash supply chain among companies. International cash management is a common corporate practice nowadays. Furthermore, some companies are implementing interorganizational information systems (IOS) with trading partners that allow them to share data and software across organizational boundaries in order to bring cash flows in line with product flows. See C Holland and G Lockett, The Evolution of a Global Cash Management System’ (1994) 36 Sloan Management Review 37; K Menyah, ‘International Cash Management in the 21st Century: Theory and Practice’ (2005) 31 Managerial Finance 3; and L Carvajal, ‘Il Finanziamento Intragruppo attraverso la Gestione Centralizzata di Tesoreria’ (LLM thesis, Università di Roma La Sapienza 2007).

247 In the eighties and nineties the European Community promoted ECIP (European Community Investment Partners), a financial instrument whose aim was to stimulate joint ventures between communitarian companies and companies (mainly SMEs) from one or more countries in Latin America, Asia and Africa. See: <http://cordis.europa.eu/finance/src/ecip.htm> A similar aim but only for Latin America is the programme called Al-Invest: <http://ec.europa.eu/europeaid/where/latin-america/regional-
There is an open recognition of the principle of good faith in performance in the project of Code of Contracts for England and Scotland drafted by McGregor in the sixties, equating good faith with what is reasonable to do:

In the making of contracts less is said about good faith as such. The accent is rather on reasonableness, which can be said to be good faith in disguise. Here the most important section is section 104: ‘The express provisions of a contract are not exhaustive and provisions shall be implied...when required to enable the contract to operate reasonably’.

This very interesting section impels the courts to imply such terms every time it is reasonable in order to enable the contract to operate. The reasonable aspect in implied terms is already present in the jurisprudence. However, in fact, judges and courts have been reluctant to make implied duties of good faith in a wide way.

In Ultraframe (UK) Ltd v Tailored Roofing Systems Ltd the judge states at para.14 that obvious commercial sense induces a particular type of conduct, namely a conduct of cooperation. The question is, ‘whether when cooperation ceases for whatever reason there are terms binding the parties to act in certain ways’. In other words, should the cooperation between the parties continue in case of a crisis during the performance of the contract? English courts imply such a term only when it is necessary in the business sense to give efficacy to the contract. Such a trend is likely to be overtaken by...
new forms of contracting that enshrine the aforementioned cooperation: partnering, strategic alliances, joint ventures, among others. The parties to these types of contracts are more likely to continue the contractual relationship in cooperation rather than to terminate it. Here, Collins asserts in relation to English law that, ‘The law must impose certain duties of cooperation in the formation and performance of contracts, which reflect the need to secure reliable and worthwhile opportunities for market exchanges’.

Cooperation in English jurisprudence is recognized as something different and superior to the mere reasonableness in the performance of the contract. A good example is *Bournemouth and Boscombe Athletic Football Club v Manchester United Football Club*.

The dispute involved a contract for the transfer of a football player from Bournemouth Football Club to Manchester United. The transfer fee was £200,000. £175,000 must be paid as initial fee with the remaining £25,000 to be paid if and when the player had scored twenty goals in first team competitive matches. Before the player had scored this number of goals he was sold to another club, West Ham United, for £170,000. Bournemouth argued that Manchester United were in breach of an implied term, effectively requiring Manchester to give the player a fair opportunity to score the goals that would trigger the £25,000 payment. The trial judge ruled in Bournemouth’s favour and a split Court of Appeal dismissed Manchester United’s appeal. If the management at Manchester United had transferred the player simply in order to avoid the bonus payment, then the Court would have certainly been unanimous, not only in treating this as bad faith but also, in agreeing that it was necessary to imply a term. However, the evidence was that the transfer was not motivated by any such reason but occurred simply because the player did not fit in with the new manager’s team plans. For the dissenting judge, Lord J Brightman, this was a perfectly legitimate reason for the transfer and he did not see how an implied term could restrict the manager’s discretion in relation to matters of team building. For the majority,

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251 See the analysis of these forms of contracting in Chapter Three, Section 3.2.
254 The Times 22 May 1980.
however, even a legitimate transfer of this kind defeated the legitimate expectation of Bournemouth to be paid. In other words, even though there was no dishonesty on Manchester United’s part, a duty of co-operation was necessarily implied.255

A number of observations are triggered by this example. First of all, was this dispute in consequence of a bad drafting by the lawyers? They limited the absolute freedom that the Manchester United manager should have always retained. The most important deduction is that, since the contract was drafted in this form, the judges recognized the implied covenant of cooperation that such a contract embodied; therefore without mentioning the general principle of good faith,256 they recognized what the principle was meant to accomplish.257

This is a relatively new assumption in English law. However, some isolated early cases recognized the duty of cooperation. For example, in Mackay v Dick Lord Blackburn stated that,

Where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect. What is the part of each must depend on circumstances.258

Another interesting case is Nissho Iwai Petroleum Co. Inc. v Cargill International S.A.259 On 13th December 1990 the sellers (Nissho) agreed to sell to the buyers (Cargill) one cargo of Brent blend crude oil for delivery in

256 In a very similar case, the New York Court of Appeals held that, ‘Every contract implies good faith and fair dealing between the parties to it’. In this case a producer of cattle food agreed to install, at considerable expense, a machine for drying and salvaging wet grain that was the by-product of a brewery. In exchange it received the brewery’s promise to sell it the used grain that it produced and salvaged for a period of five years or until half a million barrels had been brewed, after which the brewery was to become the owner of the machine. The brewery sold out its business before either of these events occurred. The New York Court of Appeals held it liable to the producer of cattle food for damages. A promise to remain in business for five years or until half a million barrels had been brewed was implied. Wiegand v Bachmann-Bechtel Brewing Co., 222 N.Y. 272, 277, 118 N. E. 618, 619 (1918).
258 (1880-81) L R 6 App. Cas. 251, 263.
March 1991 FOB in Sullom Voe at U.S. $23.54 per barrel. The contract expressly incorporated the Shell 15-day Brent terms of July 1990. Clause 3 (a) of the Brent terms provides:

Seller shall declare to buyer the Lay days (one of a certain number of days allowed by a charter party for loading or unloading a vessel without demurrage) and the Cargo reference number in respect of the Cargo not later than, and time shall be of the essence in this respect, 17.00 hours London time on the 15th Day prior to the first Day of the Lay days. Buyers shall use all reasonable efforts to ensure that the appropriate facilities and sufficient authorised personnel are available for the proper receipt of declarations (parenthesis added).

Justice Hobhouse maintained that:

It was an inevitable inference from clause 3 (a) that, the buyer having made available the facilities and personnel to receive declarations promptly, they should then be used; and it was an implied term of the contract that one party should 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 was a breach of an implied term in the contract.

In these cases, although the judges did not mention good faith, they accepted what the principle is meant to accomplish. Here, Lando states: ‘Thus to some extent the good faith principle merely articulates trends already present in English law’.

In the lex mercatoria the creditor must choose the most appropriate solution for default before giving notice to the debtor; i.e., the creditor who

260 ‘Good Faith in the Legal Systems of the European Union and in the Principles of European Contract Law’ in Mordechai Rabello (n 249) 337.
261 In the ICC award rendered in case n. 5904 [(1989) 115 JDI 1107] the parties were a European company and a provider from a developing country. At the basis of the commercial relations there were some General Conditions of the Purchase (Conditions Générales d’Achat CGA). The award applied the lex mercatoria on the grounds of the parties’ agreement: ‘Les parties ayant opté pour l’application des principes généraux et des usages normaux du commerce international’ (the parties chose the application of general principles and practices of international trade). The core of the controversy relates to a complaint from the seller, who argued that, in spite of his default in dispatching the goods on time, the cancellation of future orders by the buyer was unfair and disproportionate. This paradoxical situation led the arbitrator to decide that the buyer’s cancellation as a sanction for the delays in the dispatch of
does not receive one of a several number of deliveries is forbidden to ask for
termination of the contract straightaway. This situation – considered as a
consequence of the cooperation required in international contracts – is also
embraced in English jurisprudence. In principle, where there has been a
breach of condition – as opposed to a breach of warranty – by one contracting
party, the other party is entitled to terminate the contract. This is absolute, as
the party who has suffered the default is under no obligation to act in good
faith. However, it is possible to assert that English law has since *Hongkong Fir
Shipping Company Ltd v Kawasaki Kisen Kaisha Ltd*\(^\text{262}\) changed this by
stating that, where the parties have not specified whether a contractual term is
a condition or warranty, it is the seriousness of the breach which determines
whether there is an entitlement to terminate.\(^\text{263}\)

This part devoted to the English law will be concluded with a more
recent case which contains an express recognition of good faith in commercial
contracts: *Socimer International Bank Limited (in liquidation) v Standard Bank
London Ltd*.\(^\text{264}\)

This litigation arose from a sophisticated agreement between two
banks which, before the failure of one of them, had been trading together in
the securities of emerging markets.

The appellant (Standard) appealed against a decision\(^\text{265}\) that it was an
implied term of the forward sale agreement\(^\text{266}\) between Standard and Socimer

\(^{262}\) [1962] 2 Q.B. 26 (C.A.)
\(^{263}\) H McGregor, ‘The Codification of Contracts in England and Scotland (Equity and Good
Faith)’ in A Mordechai Rabello (n 249) 381.
\(^{264}\) [2008] EWCA (Civ Div) 116.
\(^{265}\) [2006] EWHC 718 (Comm).
\(^{266}\) J Hull in *Fundamentals of Futures and Options Markets* (4\(^{\text{th}}\) edn Prentice Hall International,
Upper Saddle River 2002) 4, defines forward contracts as follows: ‘A forward contract is
similar to futures contracts in that it is an agreement to buy or sell an asset at a certain time in
the future for a certain price. But, whereas futures contracts are traded on exchanges, forward
contracts trade in the over-the-counter market’. Regarding to the over-the-counter market, not
all shares are traded on the major exchanges, such as the London Stock Exchange and the
New York Stock Exchange. Instead of trading through the auction markets, some stocks are
traded through a network of computers and over the telephone. This non-exchange market is
known as the over-the-counter market. Shares traded in this way are often unlisted because
they do not qualify for a listing. They tend to be more thinly traded and more volatile. In the
that on termination Standard had to carry out a reasonable, objective valuation of the designated assets.

In this case Standard was the seller and Socimer was the buyer under forward sale transactions. Shortly before the failing bank, Socimer, was entered into liquidation, it was put into default; it owed its counter-party bank US$24.5 million in ‘unpaid amounts’ in respect of a portfolio of forward sales of securities which it had bought. That was on 20 February 1998, the ‘termination date’. Under the ‘standard terms for forward sales transactions’ of 8 November 1996 (the ‘agreement’), the creditor bank and seller (Standard) had to ‘liquidate or retain’ that portfolio (the ‘designated assets’) to satisfy the amount due to it. For these aims, it had to value the portfolio on the termination date. The critical sentence of the agreement that caused the litigation under analysis is to be found in clause 14 (a) (bb), which reads:

> The value of any designated assets liquidated or retained and any losses, expenses or costs arising out of the termination or the sale of the designated assets shall be determined on the date of the termination by seller.

The problem was that Standard failed to value the portfolio of assets at the termination date; instead it realised the assets over a period of time and credited Socimer with the proceeds.

Socimer sued and Justice Cooke held that the accurate construction of the agreement indicated that Standard had been obliged to value the assets as at the date of termination and to bring into the account the value as assessed as a credit against the amounts payable to Standard.

The parties were unable to agree the valuation of the assets and the issue of valuation was tried before Justice Gloster who rejected the evidence of Standard's factual witnesses on valuation, even though Socimer decided not to cross-examine them. She held that Standard had been impliedly

United States, trading in OTC or unlisted securities is monitored by the National Association of Securities Dealers (NASD). Details of OTC shares and their market makers can be found in The Pink Sheets, published daily. *Capstone Encyclopaedia of Business* (2003) <http://www.credoreference.com/entry/capstonebus/over_the_counter_market> accessed 16 May 2011

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required by the contract, not simply to carry out an honest but otherwise subjective valuation exercise but, to take reasonable care to find the true market value of the assets.

Standard submitted, on the one hand, that an implied term was not necessary but ran contrary to the agreement as a whole, which plainly gave the determination of value to Standard, in the exercise of its subjective judgment and subject to a wide discretion; on the other hand, it stated that Justice Gloster had erred in holding that certain other credits would have been set off against the ‘unpaid amounts’ so that, even on its own valuations, Standard would have had surplus assets which it would have returned to Socimer.

The appeal was allowed. The two main matters of the decision were the following:

1. As regards the latter defence, it was held that Justice Gloster had been mistaken in concluding on the evidence that certain credits owed by Standard to Socimer would have been set off against the unpaid amounts at the termination date, before they were actually due, thereby giving rise to a surplus due to Socimer. There was nothing in the evidence to suggest that Standard would have credited Socimer with those amounts before the valuation exercise.

2. As regards whether Standard’s valuation obligation was to carry out a reasonable, objective valuation, in Lord J Rix’s judgment the implied term – alleged by Socimer – was not necessary or sufficiently certain. In the judge’s words:

   Standard says that the valuation in question is not that of an expert at all: it is one to be performed by Standard ... within its discretion and according to its subjective criteria. There are standard limits in that discretion and subjectivity, which are common ground: described by concepts such as good faith, honesty, rationality, arbitrariness, perversity, capriciousness ... Thus in the specific context of a default and a forced retention of designated assets ... Standard is entitled, it
may be said, to consult its own interest, subject, of course, to the requirement of good faith and rationality.

Here, the following part of Lord J Rix’s judgement is an invaluable support for the position assumed in this thesis, namely the new approach of English courts towards good faith:

In my judgement, the requirements of good faith and rationality are a sufficient protection. The danger to be guarded against, he says (Socimer says), is abuse caused by self-interest. That is precisely what implicit good faith deals with. **Commercial contracts assume such good faith, which is why express language requiring it is so rare.** (parenthesis and emphasis added).

Ultimately, this express recognition of good faith in commercial contracts in English law determined the outcome of the appeal.

### 2.5.3 CONCLUSION: US AND ENGLISH EVOLUTION

The law of the US experienced an evolution with regard to good faith. This evolution is twofold.

Firstly, there is the obvious evolution consisting in the embracement and acceptance of good faith by statutory law, doctrine and jurisprudence.

Secondly, the US went beyond the distinction between subjective and objective good faith, merging them in the well-known definition: ‘Honesty in fact and the observance of reasonable commercial standards of fair dealing’. It is considered that this fusion reflects the current trend in contract law.

From the scholarly point of view, there is a tendency to explain the meaning of good faith in the UCC and the Restatement (Second) of Contracts as an objective criterion of reasonable behaviour in order to achieve the aim of the contract.

As regards the English law, the analysis starts with the rules that unquestionably embrace good faith, *i.e.*, those related to the insurance
contract. All the reforms proposed by the Law Commission, and the following responses that strongly support its posture in order to stress and make effective the duty of good faith on both parties to the contract, are clearly reflective of the current trend that identifies good faith with cooperation. That this is not a mere conjecture may be demonstrated with the excellent judgment on *Socimer*. Here, Lord J Rix states that the idea to be guarded against in the case of non-existence of good faith is self-interest – which is the opposite of cooperation. Commercial contracts – the judge says – imply such cooperation, ‘which is why express language requiring it is so rare’.

Does this represent an evolution from former ideas about good faith in commercial contracts? The answer is definitely positive. The radical position against good faith, formulated and adapted to meet the dimensions of an earlier state of trading, is no longer functioning in a way that correctly meets the requirements of commerce between traders.267

2.6 CONCLUSION

This thesis has shown that good faith – from its origins in Roman law – has always been a principle adopted in universal contexts, *i.e.*, in the ‘universe’ of the Roman empire and in the ‘universe’ of medieval traders – the European cities. During the nationalization of law in different countries good faith lost its universal character.

It is submitted here that the reason for the importance of good faith in universal contexts is its flexible or utilitarian character, which allows the judge to give a decision adapted to the particular circumstances of the case. Even in cases of national and political uniformity, *e.g.* England and France, it was found that there is a trend to embrace good faith or, at least, what the principle is meant to accomplish.

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267 The commerce in Europe between traders belonging to different nations led to the Draft of the Common Frame of Reference and the Commission Green Paper on Policy Options for Progress towards a European Contract Law for Consumers and Businesses, COM (2010) 348 final, which make a EU contract law instrument now highly likely. See the analysis of these instruments Chapter Four, Sections 4.4 and 4.4.1.
A point of major importance revealed by this chapter is that the different countries studied adhere to a similar notion of good faith understood as cooperation.

The current understanding of good faith is not accidental, but it is a consequence of the process of evolution of national laws applicable to commercial contracts. Hence, it is not surprising that they have adapted the notion according to the necessities of trade. In other words, since homogeneity is the first condition of all truth, cooperation – the truth of today’s commerce – has been embraced by the generality of systems of law.\textsuperscript{268}

The same rationale, \textit{i.e.}, the needs of international commerce, would explain the current understanding of good faith in the lex mercatoria as cooperation. The solution holds good. There are a number of reasons, however, which make it not completely satisfactory. That is why a second type of solution appears attractive: the influence of civil and common law systems on the notion of good faith in the lex mercatoria. The next chapter is devoted to demonstrate this point and also to show how the present state of good faith is the product of the development of the theory of contract.

\textsuperscript{268} The similar interpretation given to good faith in different legal systems represents a ‘voluntary convergence’ of legal regimes, which, according to Mistelis ‘can guarantee a commercial law framework that will assist economic development’. L Mistelis, ‘Regulatory Aspects: Globalization, Harmonization, Legal Transplants, and Law Reform – Some Fundamental Observations’ (2000) 34 Int’l L 1055, 1069.
CHAPTER THREE – GOOD FAITH IN THE LEX MERCATORIA: THE CRYSTALLIZATION OF A NEW CONCEPT

3.1 INTRODUCTION

3.1.1 PRELIMINARY OBSERVATIONS

As the title of this chapter indicates, this discussion deals with the crystallization of a concept of good faith in the lex mercatoria – which responds to the inner necessity of international trade. This concept is also significantly shaped by the influence of national traditions and history, since good faith is neither an original concept of the present time nor merely an ongoing one. It has a history and it is actually present in national legislations.

For reasons that derive from the very structure of this outlook, it is suggested in this thesis that the developments of good faith in national laws have influenced the international concept of the principle because of:

a) The constant interaction between national laws and the lex mercatoria (for example, national laws regulate those aspects uncovered by the lex mercatoria; and the latter is influencing the process of unification and harmonization of national laws);\(^1\)

b) Practitioners and arbitrators applying the lex mercatoria who, at the same time, operate in national spheres. It is important to note that arbitrators are not totally disconnected from their own national legal conceptions when acting in the international arena.\(^2\) Furthermore, the parties and their defenders may come from diverse countries with different legal and cultural backgrounds,

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\(^1\) See Chapter Four, Section 4.5.

\(^2\) The legal conceptions start to be grasped and become deeply rooted from the first acquaintance with the law of contracts. In this respect, the thoughts of Atiyah on legal education are opportune: ‘Nobody with any experience of legal teaching can doubt the power which legal concepts exercise over the minds of law students. Once a set of concepts falling into some overall pattern is grasped, the student often becomes incapable of seeing the physical facts themselves except through the conceptual process. The student learns to characterize and classify almost intuitively, and without conscious appreciation of the mental process involved; yet it is the initial act of classification which often determines the result of a case, while making it seem that the conclusion is deduced by inexorable logic from the facts’. P S Atiyah, *The Rise and Fall of Freedom of Contract* (Clarendon Press, Oxford 1979) 685.
contributing to emphasize the subjective component in the shape of the concept of good faith in the lex mercatoria.³

This chapter is based on two hypotheses.

The first premise is that good faith is the core principle of the lex mercatoria nowadays (as it was in the medieval times). This centrality is powerfully enshrined in the ICC interim award n. 9474 of February 1999,⁴ where the tribunal, by the agreement of the parties, is called to decide ‘fairly’. This was interpreted as a reference to the general standards and rules of international contracts, that is, to the lex mercatoria.

There is a strong connection between fairness and good faith. For example, the lack of a duty to negotiate in good faith means that there is less chance of liability for any pre-contractual misrepresentations, or for withdrawing capriciously from negotiations. However, in these cases Willett, the editor of Aspects of Fairness in Contract,⁵ acknowledges that there is a conflict with a fairness instinct. In the ICC award n. 9474, in fact, the arbitral tribunal called to decide ‘fairly’ considered good faith in order to base its decision of not depriving the Bank (plaintiff) of its rights to claim compensation for the violation of an agreement reached in 1993.⁶

The second assumption is that the concept of good faith has meaningful substantive content. It is not an ‘excluder’ concept to rule out

³ J Stankiewicz in ‘Good Faith Obligation in the Uniform Commercial Code: Problems in Determining its Meaning and Evaluating its Effect’ (1972-1973) 7 Val.U.L.Rev. 389, maintains that the quality of conclusions concerning the meaning and effect of good faith in the Uniform Commercial Code is totally dependent on the perceptual and conceptual abilities of the particular legal analyst. The main claim in his work is that to understand good faith as a general commercial concept the researcher should look for comparative sources and post code case law and avoid limiting it to common law sources. This is an application of his general theory which proposes that everyone involved with law has a conceptual core of legal reference. It is the subconscious sum of all prior cases (precepts) and legal theories (concepts) stored and categorized in one’s memory, which in turn is used to approach and make sense out of new legal problems or terms (new precepts).
⁵ (Blackstone, London 1996) 18.
⁶ a) Firstly, it was recognized as a principle of commercial law that a vendor cannot rely on a buyer’s failure to inspect the goods (in this case, banknotes) and to give timely notice of defects. Especially, it is generally admitted that the vendor is precluded from asserting the non-conformity of the notice if it has concealed the existence of the defect.
b) Secondly, it was asserted that the defendant knew that there had been flaws among the previous deliveries.
c) Furthermore, the tribunal considered that there was bad faith in the defendant’s conduct, since it waited more than two years before it agreed to reimburse an amount it owed. This meant that the Bank was reluctant to give straightforward notice of the aforementioned defects in the banknotes, as it feared that the defendant might then refuse to reimburse the sum due.
various things according to context.\(^7\) Here, a French author has said, ‘Imagine defining love as lacking of hatred!’\(^8\) This implies that good faith requires particular conduct.\(^9\) Yet it is difficult to formulate a universal concept of good faith. In national laws the principle has given rise to different interpretations and authors – even belonging to the same legal tradition – are not in complete agreement as to what good faith means.\(^10\) However, it is possible to establish what the concept is meant to accomplish and what it requires of the parties.

### 3.1.2 OBJECTIVES AND MEANS

The aim of this chapter is to find out how good faith is understood in the lex mercatoria, considering the aspects already established in the previous chapters.

The theoretical foundations of good faith in international trade are regarded as vital in this study and are included in this chapter.\(^11\)

### 3.1.3 RELEVANCE

Hein Kötz states that, ‘It would be a poor advocate who would simply cite §242 to the judge and invite him to dispense justice to his client according to the principles of good faith and fair dealing’.\(^12\) This opinion was developed in the context of German law where §242 BGB has given place to specific norms operating in each case (Ergänzungsfunktion). Thus, the author implies that on few occasions good faith will have a direct influence on the substance of the controversy.

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9 See the analysis of Bournemouth v Manchester United The Times 22 May 1980 in Chapter Two, n 254 and accompanying text.
10 See the three major doctrines on good faith in American law by Farnsworth, Summers and Burton in A F Farnsworth, The Concept of Good Faith in American Law (Centro di Studi e Ricerche di Diritto Comparato e Straniero. Saggi, Conferenze e Seminari, Roma 1993).
11 See Section 3.2.
On the contrary, in the lex mercatoria the principle of good faith provides the solution. Thus, it is essential to determine the connotation of this general principle when solving commercial disputes. This chapter provides international practitioners with a clear account of the understanding of good faith in international contracting. This assumes particular relevance in the context of the lex mercatoria, whose very existence is determined by the *opinio iuris atque necessitatis* or, in other words, what is generally regarded as necessary and binding.

### 3.2 THE THEORY: GOOD FAITH COOPERATION

It is submitted in this thesis that, as a consequence of the evolution of the law of contracts, from a *laissez faire* view in the nineteenth century until the rise of a cooperative view in modern times, good faith in contracts governed by the lex mercatoria is interpreted as cooperation between the parties.

In the eighties Mestre envisaged this evolution; he pointed out that, ‘[t]his (the equilibrium of the contract) could be substituted tomorrow by a spirit of collaboration more rich because naturally bilateral’.\(^{13}\) The same author pondered whether the contract will become the legal instrument for cooperation between parties.\(^{14}\) This view, in fact, is currently embraced by arbitrators applying the lex mercatoria, as will be seen in Chapter Five.

The collaborative view embraced in these new agreements created by the international commercial practice – such as franchising, engineering and transfer of technology – denotes a kind of cooperation that can be called ‘*affectio contractus*’.\(^{15}\)

Good faith understood as cooperation in international trade is the outcome of the particular circumstances of global markets and of the influence of civil and common law traditions.\(^{16}\) The cooperative nature of good faith has been emphasized by several legal scholars from the civil and the common law

\(^{13}\) J Mestre, ‘*D’une Exigence de Bonne Foi à un Esprit de Collaboration*’ [1986] RTD Civ 100, 102.

\(^{14}\) Ibid 101.

\(^{15}\) See n 51 & 52 and accompanying text.

\(^{16}\) See Chapter Two, Section 2.3.
traditions. For instance, two legal experts – one a scholar from the civil law tradition and the other a judge of the common law jurisdiction – agree, in fact, on these terms. Díez-Picazo considers good faith, not just as hindering acts that harm others but also, as imposing a positive behaviour of cooperation. An Australian judge, Paul Finn, however, accepts that contracts are about the pursuit of self-interest but argues that good faith also requires a contracting party to take the other’s party interest into account.

This theory of good faith cooperation is deeply entrenched in what has been called by Atiyah ‘the decline of contract’ and its consequences: the avoidance of litigation and the smooth solution of conflicts. A hypothetical example can illustrate this assertion:

Two companies which have a long standing commercial arrangement by which one provides supplies to another may end up by merging into a single corporate entity or group… The parties often proceed as though they were engaged on a joint venture, and not in a bargain in which they have mutually irreconcilable interests. In the event of default, an adjustment of the terms of the relationship for the future is far more likely than litigation.

The same author states, ‘We shall see too some signs of recognition that parties may owe duties of care to each other in the bargaining process, something utterly alien to the classical model of contract’.

Zimmermann speaks about the ‘rematerialization of contract law’ in the sense that there is an emphasis on loyalty, protection of trust, cooperation and concern about the interest of the other party and substantial justice. This is far from the exaggerations of Positivism and the predominance of will in the

17 L Díez-Picazo, La Doctrina de los Actos Propios (Bosch, Barcelona 1963) 139. French author Demogue also emphasizes the cooperative nature of contracts in Traité des Obligations en Général T.6 (Rosseau, Paris 1931) 9.
19 Atiyah (n 2) 716.
20 Ibid 724-5.
21 Ibid.
nineteenth century. This implies a renaissance of the ethical foundations of
the theory of contract.23

Therefore, the findings in national laws and the opinion of scholars
hitherto suggest that nowadays good faith cooperation provides the optimum
conditions for international commercial contracts. The background of this
theory will be explored in the following section.

3.3 THEORETICAL FOUNDATIONS OF GOOD FAITH COOPERATION IN
THE LEX MERCATORIA

The current state of good faith in the lex mercatoria is closely related to
the globalization of trade in the second half of the twentieth century and the
early years of the twenty first.24 In previous times, during the nineteenth
century, contractual individualism was the theory in vogue in the ‘civilized
world’.25

Individualism has its antecedents in the eighteenth century26 doctrine of
rationalism, described by Pope Leo XIII as ‘the supremacy of the human
reason, which refusing due submission to the divine and eternal reason,
proclaims its own independence, and constitutes itself the supreme principle
and source and judge of truth’.27
Rationalism\textsuperscript{28} raised the doctrine of \textit{volonté générale} or social contract as the basis for legal norms. Here, it has been said: ‘Rationalism which had begun by raising human reason to the throne of God, ended by abdicating unconditionally in favour of will, whether it is the will of the State, of the dictator, of the bourgeois individual or of the proletarian class.’\textsuperscript{29}

However, things were destined to change under the new conditions that the economy would present at the beginning of the twentieth century: the growth of the population and the growing scarcity of resources. The business profit was not the only motive but there was also an intensification of the search for economic and social equality. England moved to this new approach before other nations. Perhaps this was because the Industrial Revolution took place in Britain in the second half of the eighteenth century before other nations (only from 1830 to the early twentieth century, the Industrial Revolution spread throughout Europe and the US, and to Japan and the various colonial countries). Hence, Britain had more time to assimilate the transition from a hierarchical society to industrialism (where classical liberalism reigned) and then to collectivism.\textsuperscript{30} Collectivism, in the sense of creation of a partial welfare state and a circumscription of liberties, took place in America, according to Carson, only during the twentieth century.\textsuperscript{31}

By contrast, collectivism has been ingrained in Eastern culture for millennia. For example, Confucian ethics is basically humanistic and collectivistic in nature.\textsuperscript{32} It is humanistic since its primary concern is the human condition. It is collectivistic because it places the importance of collective values and interests above individual ones. According to this theory, a Confucian person is essentially a social being.

The core of Confucian ethics is constituted of three elements – \textit{ren}, \textit{yi} and \textit{li} define what is morally acceptable in human society. \textit{Ren} is the capacity

\textsuperscript{28} The individual and its reason are two pillar of Immanuel Kant’s theory. See Britannica Guide to the Ideas that Made the Modern World (Constable and Robinson, 2008) XIV.
\textsuperscript{29} John Wu, \textit{Fountain of Justice} (Sheed and Ward, London 1959) 135.
\textsuperscript{30} Dicey in his \textit{Lectures on the Relation between Law and Public Opinion in England during the Nineteenth Century} published in 1905, already speaks about the second half of the nineteenth century as the period of ‘collectivism’, while in America individualism still held sway.
\textsuperscript{32} Confucius (Kong Fuzi) was born in 551 BC.
of compassion or benevolence for fellow humans. It is essentially expressed in social relationships. Yi can be defined as righteousness and, according to Mencius (371?–288? BC) it is inseparable from human nature.\(^{33}\) Li represents the norms and protocols in personal and institutional lives. The legitimacy of li is based on ren and yi, and only under this condition are people obligated to follow it. Traditional Chinese culture and modern Chinese communities deem ren, yi, li, wisdom and trustworthiness as the five cardinal virtues of humanity. For this reason, Roebuck and Wai-Ip assert that the current law of China accepts the principle of good faith, not only because of the influence of German and Soviet law but, mainly because good faith fits Chinese traditional thinking.\(^{34}\) E.g. China’s current Foreign Economic Contract Law provides in article 3 that, ‘Contracts shall be concluded in accordance with the principles of mutual benefit and equality, and reached by unanimity by consultation’. However, Keung Ip points out:

Since the founding of the People’s Republic in 1949, the communist authorities have tried hard to replace the old feudalistic tradition with the new socialist culture. Being perceived as the crown jewel of feudalism, Confucianism had been systematically demonized, suppressed and purged. Despite this harsh and brutal treatment, Confucianism recently finds a comeback, thanks to the endorsement by many top government officials ... On the academic side, local and overseas scholars have been promoting the values of Confucianism in the building of a business moral order in China.\(^{35}\)

To return to Western culture: during the aforementioned period of collectivism in the Western world, Spencer, a defender of liberal principles,

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\(^{35}\) Po Keung Ip, ‘Is Confucianism Good for Business Ethics in China?’ (2009) 88 Journal of Business Ethics 463, 473. This author (at p. 467) reveals the dark side of Confucianism: ‘Confucian reciprocity, in general, is asymmetrical as a result of the embedded hierarchical human relationships that Confucian (sic) sanctions and supports. Indeed, far from being benign, hierarchy when meshed with authoritarianism breeds a domination-subservient social structure that is harmful to the individual’s dignity and autonomy’.
argued against what he called ‘compulsory cooperation’, a form of cooperation imposed from above. Instead, he proclaimed a voluntary cooperation, as a consequence of the evolution of society. In short, he stated that, since liberal society evolved from a hierarchical society prior to the industrial revolution, to come back to collectivism would mean a regression. Collectivism is, of course, where the state imposes rules for the good of the general population.

*Prima facie* these theories about the role of the state could seem far from a theory of good faith in international contracts. However, the foundation of a more or less restrictive conception of contractual freedom and, as a result, the way to interpret good faith, both derive from the historical reality and the schools of thought in a particular time and place. It must be remembered that law is essentially an ordinance of reason directed to the common good. It is a teleological, not a mechanical, science. Consequently, the determination of what is good faith differs according to differing times, as has been seen in the previous chapter.

Generally, good faith in international contracts was present from 1880 onwards, the period known as collectivism, as a compulsory cooperation (in the way denounced by Spencer), since it was applied under the aegis of international private law. Good faith fulfilled its role in cross-border agreements guided by the strictness of municipal systems of law. By contrast, nowadays good faith in the lex mercatoria represents the voluntary

36 B Malinowski in *Crime and Custom in Savage Society* (8th edn Routledge, London 1966) 64 states that: 'The fundamental function of law is to curb certain natural propensities, to hem in and control human instincts and to impose a non-spontaneous, compulsory behaviour – in other words to ensure a type of co-operation which is based on mutual concessions and sacrifices for a common end'.


38 This is the view of the sociological school of jurisprudence – followed here. The sociological school of jurisprudence studies the circumstances which create the legal institutions, and the relationship between those legal institutions and other social institutions which condition the scope and the operation of law. In this school of thought, law is thought of as a social institution which serves collective social purposes and interests (as opposed to merely serving individual purposes and interests). Another important element is that it believes that human experience is the basis of law and that law is designed to meet dynamic social needs. See R Pound, ‘The Scope and Purpose of Sociological Jurisprudence I’ (1911) 24 Harv.L.Rev. 591; and R Pound, ‘The Scope and Purpose of Sociological Jurisprudence II’ (1911-1912) 25 Harv.L.Rev. 140.

39 See Carson (n 31) Chapter 5.

40 H Spencer, ‘From Freedom to Bondage’ in Taylor (n 25).
cooperation to which Spencer aspired. The *societas mercatorum* is – in fact and spontaneously – applying or understanding good faith as cooperation for the common good of everyone involved in the contract and affected by it. In this sense good faith could be considered as a moral principle, without fearing to introduce subjective parameters. Here, Max Nordau comments on Hegel’s ideas: ‘To act morally is to act so as to ensure the well-being of the community. The real categorical imperative is a social conscience.’

The understanding of good faith as cooperation in our particular time in the history of humankind implies that we are part of a society in evolution as the individual is in constant evolution – in an ontological sense:

> The industrial social type is made possible by an improvement in individual moral character which is the work of many generations. As individuals become more socialized, and develop ‘higher’ moral sentiments, like a love of liberty and a respect for the rights of others, so the social order come to be produced spontaneously by their voluntary contractual agreements.

Cooperation, as a particularity of the behaviour of parties in an international contract, is the product of the development of the contract theory, which is, at the same time, influenced by the changes in society. English law is a good illustration in this sense, since it has evolved from an initial liberal approach to the promotion of fairness.

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41 Durkheim, an advocate of contract solidarity, held that moral rules are compulsory and also, desirable. Durkheim, *Sociologie et Philosophie* (Librairie Félix Alcan, Paris 1924) 50.


43 J A Hobson, ‘Introduction’ in Taylor (n 25) XVIII.

44 For an example of this approach, see British House of Lords in *Tsakiroglou & Co. Ltd. v Noblee Thol G.m.b.H* [1962] A.C. 93, upholding the decision of the umpire to whom the dispute was originally referred, the board of appeal, Justice Diplock and the Court of Appeal, who all rejected the appellants’ contention (namely, that the contract of sale c.i.f. was frustrated because the usual and customary shipment route, Suez Canal, was blocked during the time established for performance). They held the appellants liable to the respondents. It was stated that, although the alternative route – Cape of Good Hope – involved a change in the method of performance of the contract, it was not such a fundamental change from that undertaken under the contract as to allow frustration. The following facts are worth considering to appraise the judgment: the distance from the original Port Sudan to the port of destination (Hamburg) via Suez Canal is app. 4,386 miles; via Cape of Good Hope it is app. 11,137 miles. Besides, the freight surcharge placed on goods shipped on vessels proceeding via the Cape of Good Hope was increased from 25 to 100 per cent during the period of performance. Despite these elements, the alternative route was held a ‘reasonable and practicable route available’.

45 See Chapter Two, Section 2.5.2.
Collins offers the case of *Schroeder Music Publishing Co Ltd v Macaulay*, where the House of Lords annulled a contract on the basis of unfairness of the agreement, as an example of the new trend of English courts to punish unjustifiable domination, to procure the equivalence of exchange and to ensure cooperation between contractual parties. The author justifies the enshrinement of these values with a new understanding of the market order, which implies a revised notion of liberty and autonomy where ‘the ability to enter into binding commitments is interpreted, not as a general licence but, as a power to be exercised for worthwhile purposes’. Collins considers this the philosophy behind his own work: ‘These three elements – the concern about unjustifiable domination, the equivalence of the exchange, and the need to ensure co-operation – which seem to me motivate the decision in *Schroeder Music Publishing Co Ltd v Macaulay*, form the core of the interpretation of law of contract presented in this book’.

When two or more parties meet to agree on a commercial contract their purpose is to profit from the business and their intentions are not assistance or charity. The logical question is, therefore, how does the cooperation between traders become effective? This gives rise to a host of observations and reflexions. The following is an attempt to condense them:

The cooperation between traders becomes effective if the behaviour of the parties is directed towards the fulfilment of their reciprocal expectations when contracting. What a party can expect during the different phases of the contract is that the other party will do what the facts require to accomplish the aim of the contract. Even if the fulfilment of the purpose of the contract is not possible, good faith requires cooperating to contain the damages derived from the frustration of such aim.

During the performance the parties’ interests are directed towards that aim. In this sense, the concept of ‘cooperation’ must not be confused with the idea of ‘collaboration’. As regards these notions, Williams suggests:

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48 Ibid 29.
Collaboration can refer to group activity within any corporate conglomerate or subsidiary activity and can easily be little more than assent to authority according to a feudalistic, hierarchical organizational system. Cooperation, on the other hand, is rooted in a highly democratic, participatory, and group-directed process. Cooperation demands a move away from a mere collaborative attitude within a typical corporate command chain (emphasis added).\textsuperscript{49}

To paraphrase this impeccable explanation: cooperation in contracts means a move beyond, in the sense that it requires effective steps to fulfil the legitimate expectations of the other party – not only the proscription of undesirable conduct.\textsuperscript{50}

This movement beyond can be well appreciated in the trend of new forms of contracting that enshrine cooperation: partnering, strategic alliances, joint venture, franchising, construction,\textsuperscript{51} groups of companies and technology cooperation, among others. Consider here, for instance, partnering in the construction industry. It appears to be almost universally accepted that partnering requires, ‘changing traditional relationships to a shared culture … based upon trust, dedication to common goals, and an understanding of each other’s individual expectations and values’.\textsuperscript{52} Partnering documents contain the language of ‘good faith’ and pose to judges the challenge of interpreting it in a manner that complies with the expectations of the parties:

For example under the Joint Contracts Tribunal (JCT) Non-Binding Partnering Charter the parties agree to act in good faith; in an open and trusting manner; in a co-operative way; in a way to avoid disputes by adopting a ‘no blame’ culture; fairly towards each other; and valuing the skills and respecting the responsibilities of each other.\textsuperscript{53}

\footnotesize{\textsuperscript{49} R C Williams, \textit{Cooperative Movement: Globalization from Below} (Ashgate Publishing, Aldershot 2007) Introduction. \\
\textsuperscript{50} Similarly, Christian morality not always prohibits but asks ‘love your neighbour as yourself’. This is one step further, which departs from the suppression of the impulse of selfishness and prolongs its effects until it changes the impulse of selfishness and indolence into its very antithesis: love.
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\textsuperscript{52} ‘In Search of Partnering Excellence’ (1991) 17 Special Publication CII Austin TX. \\
The concept of cooperation in today’s commerce frequently surpasses the arena of economic exchange and enters into a field of long-term strategic considerations regarding relationships between companies. The concrete motives that lead companies to cooperative efforts can vary widely. For example in technology partnering, the motives go from reducing the cost of research in high-tech industries and the cost of advanced-system design, such as in telecom and aerospace, to the possibility of capturing some of the capabilities, knowledge or technologies of partners or the possibility to create new markets and products. The underlying current of all these contracts made to attain these objectives is cooperation, in the way proposed in this work.

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CHAPTER FOUR – GOOD FAITH IN INTERNATIONAL INSTRUMENTS REPRESENTATIVE OF THE LEX MERCATORIA

The aim of this chapter is to explain the features of good faith as a principle in those instruments that enshrine the lex mercatoria. This is done through the analysis of the text of these instruments, arbitral awards given on their basis and real and hypothetical examples.

4.1 THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALES OF GOODS (CISG)

Since 1980 new elements have been added to the substance of the lex mercatoria. Most notably among those elements is the Convention on Contracts for the International Sales of Goods (CISG),\(^1\) which, it is generally recognized, embodies universal principles applicable in international contracts.\(^2\)

Article 7 (1) is the only formal article on good faith:

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.\(^3\)

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\(^1\) The Convention on Contracts for the International Sales of Goods (CISG) was signed in Vienna in 1980 and came into force on 1 January 1989. As of 7 July 2010, UNCITRAL reports that 76 States have adopted the CISG. The methodology adopted by the Vienna Sales Convention is to embrace substantive rules specially designed for international transactions, that is to say, once it is ratified, it provides directly applicable rules.

\(^2\) In ICC award n. 5713 it was stated: ‘The tribunal finds that there is no better source to determine the prevailing trade usages than the terms of the United Nations Convention on the International Sales of Goods of 11 April 1980, usually called “the Vienna Convention”. This is so even though neither the country of the buyer nor the country of the seller are parties to that Convention. If they were, the Convention might be applicable to this case as a matter of law and not only as reflecting trade usages’ (1990) 15 Yb Comm Arb’n 72

\(^3\) Likewise, article 5 of the UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit of 1995 provides: ‘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 the international practice of independent guarantees and stand-by letters of credit’.
This rule refers to the interpretation of the Convention, but not to the interpretation of sale contracts governed by it. The article is ambiguous because it is the result of a formal commitment between countries which wanted a general norm about good faith and those that did not accept such a norm. However, in this respect Tetley states, ‘Clearly, art. 7 (1) must be read more broadly, as imposing an obligation of good faith conduct in international trade. Generally there is support for the broad reading of article 7 (1)’.  

In line with this position, here is an example drawn from a national common law jurisdiction where good faith is applied as a standard of behaviour for the parties to a contract on the basis of article 7. In *Renard Constructions v Minister for Public Works*, Justice Priestley mentioned CISG for the first time in Australia. He concluded that ‘reasonableness in performance’ was implied in the contract concerned and then likened this to notions of good faith in Europe and the US, and noted that, although such a concept was not yet fully accepted in Australia (because it is based on the English legal tradition), ‘the time may be fast approaching’.  

Although there is not an express reference to contractual good faith in CISG, it is an underlying principle of many of its norms. For example, the statements and conducts of the parties are to be ‘interpreted according to the understanding of the reasonable person’; article 77 illustrates the possibility to incur liability in cases of not using good faith in the mitigation of damages. Here, Klein also identifies good faith in several articles of this Convention, for example:

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6 The principle of good faith, as embodied not only in article 7 but also in the most specific provisions such as article 16 (2) (b), 21 (2) and 40 of the CISG, is acknowledged as one of the general principles on which the Convention is based. N Hofmann, ‘Interpretation Rules and Good Faith as Obstacles to the UK’S Ratification of the CISG and to the Harmonization of Contract Law in Europe’ (2010) 22 Pace Int’l L. Rev. 145, 168.
7 Article 8 (2) CISG.
8 Art. 77 reads as follows: A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.

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Under article 29, the modified agreement is enforceable by either party in the event of other’s breach, because each had relied on the conduct of the other. While the words ‘good faith’ are nowhere to be found in article 29, it is clear that the outcome in this scenario is grounded largely on the good faith obligation.\(^9\)

To sum up: in spite of the absence in CISG of an explicit good faith provision, the principle still stands. The articles of the Convention provide ample opportunity for an arbitral panel to exercise flexibility in the interpretation of the contract.\(^{10}\) This is in complete harmony with the current trend in international commerce, consisting of a shift from the strict enforcement of contract to an emphasis of fairness in the exchange and good faith norms.

**4.2 UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS**

**4.2.1 PICC IN INTERNATIONAL TRADE**

The UNIDROIT Principles of International Commercial Contracts (PICC) are the result of the work of a group of experts coming from different legal traditions who gathered at the International Institute for the Unification of Private Law (UNIDROIT).\(^{11}\) The Principles are ‘soft law’. That is, they are not binding upon the parties or the states, unless ‘the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like’.\(^{12}\)

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\(^9\) J Klein, ‘Good Faith in International Transactions’ (1993) 15 Liverpool L.Rev. 115, 130. Article 29 (2) reads: A contract in writing which contains a provision requiring any modification or termination by agreement to be in writing may not be otherwise modified or terminated by agreement. However, a party may be precluded by his conduct from asserting such a provision to the extent that the other party has relied on that conduct.

\(^{10}\) Good faith is certainly a factor in the application of article 8 that deals with the interpretation of the parties’ statements and conduct in order to ascertain their obligations, of article 16, article 29, article 35 (3) and of article 80, among others.

\(^{11}\) This is an independent intergovernmental organization with its seat in Rome.

\(^{12}\) See the Preamble of the Principles. The 2004 version of the Principles is the one used in this thesis. The 90th session of the Governing Council of UNIDROIT adopted the third edition of the UNIDROIT Principles of International Commercial Contracts (‘UNIDROIT Principles 2010’), which contain new provisions on restitution in case of failed contracts, illegality, conditions, and plurality of obligors and obligees, while with respect to the text of the 2004 edition only significant changes made relate to the Comments to article 1.4 (Mandatory rules).
It is submitted in this thesis that the UNIDROIT Principles reflect a new sagacious approach to the subject of commercial contracts.¹³ PICC rose as result of the international community’s awareness of the changing role of the contract in international business. From ‘discrete’ transactions, transnational contracts have gradually developed into a genuine source of transnational commercial law. The PICC stands for this dramatic change in one of the most important areas of international business law.

Scholars regard PICC in two ways.

a) The first position postulates that the Principles cannot be considered the lex mercatoria *ipso facto*. Their provisions must be validated as part of the lex mercatoria throughout their effective application and, most importantly, throughout the *opinio iuris atque necessitatis*; which means, the conviction in the mercantile community about their binding and necessary character.¹⁴

b) The second position (whose most renowned exponent is Galgano) makes these Principles the reflection of the lex mercatoria, ‘From the lex mercatoria an organic compilation has been formed, under the name of Principles of International Contract Law’.¹⁵

Considering that the lex mercatoria needs to be accepted as binding by commercial operators and that PICC present a high degree of abstraction – as they are the result of a process of creation by legal experts – the first position seems to be the better approach. Here, Berger holds that PICC should be called a ‘Pre-Statement’ rather than a ‘Re-Statement’ of transnational contract law. In any case, he regards these Principles as the ‘Magna Carta’ of

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¹³ Contrary to the scope of all existing international conventions, including CISG, PICC are not restricted to a particular kind of transaction but cover the general part of contract law.
¹⁵ F Galgano, *La Globalizzazione nello Specchio del Diritto* (Il Mulino, Bologna 2005) 64. See p. 74-5 of this book where the author recognizes the origin of the lex mercatoria in the community of merchants, but, he adds, ‘it is applied after receiving the cultural filter of UNIDROIT’.
international commercial contracts. This perspective is also assumed in international practice. For example, according to the abstract of the ICC partial award n. 10022:

The arbitral tribunal decided that it would refer, when necessary, to ‘the relevant trade usages’ according to article 17 of the ICC Rules of Arbitration, and that such reference included but was not limited to the UNIDROIT Principles and the Principles of European Contract Law (emphasis added).  

Ultimately, these Principles can be characterized as rules of consensus between experts on the best solutions for international commercial contracts. Among them, there are some norms that already reflect the standard practice in international trade. An illustration is, for example, an arbitral case in which the parties were invited to express their views of the principles to be applied under the lex mercatoria. In reply, they referred to norms contained in the UNIDROIT Principles and the CISG. The arbitral tribunal considered – with only one exception – that the parties have rightly identified the interpretative principles to be applied (the main problem was one of interpretation).  

In practice, in those cases where the PICC effectively reflect the lex mercatoria, they are naturally called to supplement and complement national laws and CISG in arbitration. Frequently, contracts contain a choice of law clause designating the law of a particular state. In addition, parties explicitly agree to the complementary and supplementary application of the general principles of international law. Sometimes, in the latter case, reference is expressly made to the UNIDROIT Principles. For example, in the arbitral case between Ministry of Defence and Support for the Armed Forces of the Islamic Republic of Iran v Cubic Defence Systems Inc. the supplementary aspect is

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19 Dalhuisen states, ‘The empirical evidence suggests that parties do not specifically apply the general principles of the lex mercatoria as proper law in their arbitration agreement or, if so, do it to supplement rather than displace national law. Thus, only one to two per cent of clauses given raise to ICC arbitration in 2002-2003 provided for transnational or other non-national law as the governing law’. J H Dalhuisen, Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law (3rd edn Hart Publishing, Oxford 2007) 604.
expressed in a clause that entitles the parties to request unilaterally termination of the contract or adaptation of its terms on the basis of article 6.2.3 (4) [Effects of Hardship]. It was considered that the clause *rebus sic stantibus* is a general principle of law and, therefore, applicable to this case, even if it did not form part of the Iranian law.  

4.2.2 GOOD FAITH IN INTERNATIONAL TRADE AS PART OF THE PICC

Now that the character of the PICC in the international sphere is clear, the next stage is to state the features of good faith in these Principles.

Firstly, in practice the PICC are invoked by national judges and arbitrators to strengthen their perceptions of the trends in international commercial law; thus, in fact, good faith is acting as an overarching principle underpinning solutions given by international arbitrators. An example might help to clarify this. In the ICC award n. 10335 of October 2000 the award was based on Greek law, among other norms, under article 200 of the Greek Civil Code which states: ‘Contracts shall be interpreted according to the requirement of good faith taking into account business usages’. In addition, the arbitral tribunal mentioned other norms of European civil codes and, in order to demonstrate that ‘modern international law is evolving in the same direction’, expressly referred to articles 1.7, 1.8, 4.1 and 4.3 of the UNIDROIT Principles.  

Secondly, since the UNIDROIT Principles have exercised and will continue to exercise a considerable influence over the harmonization of the business law of regional blocks such as Africa and American States, the way to embrace good faith in these Principles is also enshrined in those projects of the unification of national business laws. This has an enormous

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22 The Preamble of the Principles declares that, ‘They may be used to interpret or supplement international uniform law instruments. They may be used to interpret or supplement domestic law. They may serve as a model for national and international legislators’.
23 The reason for the influence of PICC over the harmonization of business laws in different regions is their comparative, empirical and universal background.
impact in the system of commercial law as a whole, in the sense that there is
a transposition of the concept of good faith from the lex mercatoria towards
national systems and vice versa.\textsuperscript{24}

\textbf{4.2.3 FEATURES OF GOOD FAITH IN THE PICC}

\textbf{4.2.3.1 GOOD FAITH IS A FUNDAMENTAL IDEA UNDERLYING THE
PRINCIPLES}

One of the main ideas that underlie the UNIDROIT Principles is
good faith.\textsuperscript{25} It is postulated in this thesis that this and other underlying ideas such
as flexibility\textsuperscript{26} are harmoniously and consistently applied by arbitral tribunals in
international contract disputes.

However, this thesis can be challenged in its basis by a notion
proposed by Hyland, who sees an internal inconsistency in the UNIDROIT
Principles. According to him, the Principles are inspired by contrasting
conceptions: natural law (\textit{pacta sunt servanda}) and risk allocation. Because of
such incoherence, uniform interpretation according to the ideas underlying the
Principles, as provided by article 1.6, is unfeasible; the courts might construe
the norms in different ways.\textsuperscript{27}

It is generally known that \textit{pacta sunt servanda} requires the individuals
to be bound by their promises; in consequence, the sanction for breach of
contract is greater when the breach is intentional. Likewise, penalty clauses
are enforced because they have a punishment goal. Another consequence of
such approach is the mitigation of damages. French civil law and the codes
that follow the \textit{Code Napoléon} around the world do not accept the mitigation
of damages because that would mean to burden the innocent party. By
contrast, risk allocation does not consider the promisor bound by law to
perform the promise. The promisor remains free to breach. The central

\textsuperscript{24} This idea is further developed below: see Section 4.5.2 figure 1 of this chapter.
\textsuperscript{25} See the official comment of article 1.7 PICC. D Tallon in \textit{Le Concept de Bonne Foi en Droit
Français du Contrat} (Centro di Studi e Ricerca di Diritto Comparato e Straniero, Roma 1994)
2 states, ‘\textit{Et l’on sait que les partisans de la lex mercatoria fait de la bonne foi la base même
de celle-ci}’ (‘We know that the partisans of the lex mercatoria make good faith the foundation
of it’).
\textsuperscript{26} See the Introduction to the 1994 edition of the Principles.
541.
objective behind the system of contract remedies is compensatory, not punitive.

Hyland, in addition, states that the UNIDROIT Principles, influenced by the common law, tend more toward the conception of risk allocation.\textsuperscript{28}

To respond to Hyland: it is not possible to accept the risk allocation theory in essence and, even less, as a partial basis for some of the rules of the UNIDROIT Principles.

Risk allocation is an idea borrowed from Oliver Wendell Holmes, who proposed that contract law’s only aim was to guarantee the boundaries of the field of promising without involving moral judgements of conduct.\textsuperscript{29} Holmes argued:

In the case of a binding promise that it shall rain tomorrow, the immediate legal effect of what the promisor does is, that he takes the risk of the event, within certain defined limits, as between himself and the promisee. He does no more when he promises to deliver a bale of cotton. If it be proper to state the common-law meaning of promise and contract in this way, it has the advantage of freeing the subject from the superfluous theory that contract is a qualified subjection of one will to another, a kind of limited slavery. It might be so regarded if the law compelled men to perform their contracts, or if it allows promisees to exercise such compulsion. If, when a man promised to labor for another, the law made him do it, his relation to his promisee might be called a servitude \textit{ad hoc} with some truth. But that is what the law never does... The only universal consequence of a legally binding promise is that the law makes the promisor pay damages if the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfilment has gone by, and therefore free to break his contract if he chooses.\textsuperscript{30}

Holmes’s position is not convincing. Law is based on the idea of justice which utterly embraces morals. An essential connection between law and morals emerges from an examination of how laws are interpreted and applied in concrete cases. Consider, for example, the case of protection of expectation interests, by which the plaintiff is compensated up to the point

\textsuperscript{28} Ibid 547.
\textsuperscript{30} Ibid 235.
where it would be, should the contract be performed.\textsuperscript{31} The defendant is, of course, free to perform but the system provides in such a way that the promisor is highly prompted to fulfil the promise. There is a morality of promise-keeping at the base.\textsuperscript{32} This approach belongs to the deep field of the philosophy of law. The following brief explanation is offered for the sake of intellectual rigour.

Legal positivism postulates the separation between law and morals, or, in other words, the distinction between law as it is from law as it ought to be.\textsuperscript{33} Other authors conclude that moral notions of justice must be necessarily involved in the analysis of any legal structure.\textsuperscript{34} The view held in this thesis – it is evident – is with those who regard that there is an interconnection of law and morals.\textsuperscript{35} Here, Burrows remarks:

The common law is best regarded as a coherent system of principles, reflecting a complex mix of ‘moral rights’ reasoning, modified and tempered by the desire to pursue certain long-term social policies. One important social policy is efficiency; but its place is alongside, not as a replacement for, moral rights reasoning, and this is how it is used in this book.\textsuperscript{36}

\textsuperscript{31} Here, in ICC award n. 8264 of 1997 in (1999) 10 ICC Int’l Ct.Arb.Bull. 62, the arbitral tribunal held that claimant’s failure to provide respondent with information relating to the equipment caused the latter the loss of an opportunity to develop and adapt its industrial production to the demands of the market. The tribunal referred to article 7.4.3 (2) of the UNIDROIT Principles which reads: ‘Compensation may be due for the loss of a chance in proportion to the probability of its occurrence’.


\textsuperscript{33} See H L A Hart, ‘Positivism and the Separation of Law and Morals’ (1958) 71 Harv. L.Rev. 593. It is worth dispelling here a source of confusion as regards positivist theories: ‘Positivism does not strictly deny the importance of moral, ethical or even political quality of law, but the relegation of these issues to a realm beyond jurisprudence increasingly seemed to exclude matters from consideration which were not peripheral but central to the operation of law in the modern world’. The quotation is from J E Penner, McCoubrey & White’s Textbook on Jurisprudence (4th edn OUP, Oxford 2008) 101.

\textsuperscript{34} Here, Gustav Radbruch – who lived through the horrors of the Nazi regime – considers that fundamental principles of humanitarian morality are part of the very concept of Recht or legality. See F Haldeman, ‘Gustav Radbruch v. Hans Kelsen: A Debate on Nazi Law’ (2005) 18 Ratio Juris 162.


\textsuperscript{36} A Burrows (n 32) 12. This position could be conceived as a limitation to the theory of the Chicago School of Law and Economics. This theory is considered an improved model of utilitarianism and propounds the central role of efficiency in the common law. The following is an attempt to explain the core of this theory: Bentham’s utilitarianism was based on the ‘felicific calculus’, the greatest happiness to the greatest number. The felicific calculus, however, is difficult because it is uncertain how people will react to alternative measures. To
It is worth mentioning that this statement has been taken from a book on the ‘Breach of Contract’, the cornerstone of Holmes’s theory.

To sum up, since the risk allocation theory has been ruled out as a possible back-up philosophy of any system of law, it cannot serve such purpose in the UNIDROIT Principles either. As a result, there is no inconsistency but coherence in the ideas sustaining this body of Principles – one of the most important of those is good faith, as it will be seen.

Good faith is explicit in article 1.7 of the Principles, which states that, ‘Each party must act in accordance with good faith and fair dealing in international trade’ and they ‘may not exclude or limit this duty’.

Good faith is qualified by ‘fair dealing in international trade’. The reference to international trade forbids the interpreter to give a domestic connotation to good faith. That is, anyway, the common practice in international arbitration. Yet, as it has already been seen, the very concept of good faith in international trade is coinciding with and interrelated to good faith in the two main traditions studied – civil and common law.

It is also opportune to reflect on the mention of fair dealing in this article. This is not a novelty in commercial matters. There is an antecedent in the experience of the US in the UCC. On the one hand, Section 1-304 (formerly 1-203) states:

Every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement.

Good faith in this case is mentioned singularly, i.e., no reference to fair dealing is made. On the other hand, Section 1-201 defines good faith as:

\[\text{overtake that, the economic analysis of law makes an assumption: human beings are rational maximizers of their satisfactions. The } \text{felicific calculus} \text{ is also problematic because of the empirical difficulties in finding out what people do in fact want. To this the economic analysis of law proposes: ‘What I want is, by definition, what I am willing to pay for – either in money, or by the deployment of some other resource that I have such as time and effort’. See J W Harris, } \text{Legal Philosophies} \text{ (2nd edn Butterworths, London 1997); see also R Posner, ‘Utilitarianism, Economics, and Legal Theory’ (1979) 8 J.Legal Stud. 103.} \]

37 See the official comment of article 1.7 of the PICC.
Honesty in fact and the observance of reasonable commercial standards of fair dealing.

That means that fair dealing is part of the concept of good faith in this jurisdiction. By including fair dealing in the definition, the legislator wanted to offer an objective criterion of good faith which is measurable according to the particularized settings in which it is applied.\(^3^8\) Similarly, the Dutch legislature uses the term good faith in an objective manner and, accordingly, characterizes the term in the sense of reasonableness and fairness.\(^3^9\) The same approach seems to be adopted in the PICC. Despite the fact that they are inconsistent in their coupling of good faith and fair dealing throughout the articles, according to Farnsworth (who was part of the drafting group for the Principles), ‘one may assume ... that the inclusion of fair dealing imposes an objective standard as established by relevant trade practices’.\(^4^0\)

4.2.3.2 A CORRECTIVE TO THE AUTHORIZED NOTION: GOOD FAITH IS PRAGMATIC

According to Bonell\(^4^1\) the UNIDROIT Principles are receptive to the realities of international practice. However, through good faith an attempt would be made to bring about conditions of equilibrium and correctness in international relations.\(^4^2\)

Could this instrumental-corrective character be considered as a feature of good faith in the Principles?

Good faith in this context would be part of a number of other protective norms in the UNIDROIT Principles, \textit{inter alia}: articles 1.9; 2.1.20; 3.8; 3.9; 3.10; 4.6; 7.1.6 and 7.4.13. The absolutist view on the essentiality of protective norms is that of Galgano, who describes the Principles as an


\(^3^9\) See Chapter Two, n 74.


\(^4^1\) Bonell was chairman of the working group for the preparation of the UNIDROIT Principles of International Commercial Contracts 2004.

‘illuminated work of techno-democracy in the research for the equilibrium between opposite interests, between the reasons of the company and the need to protect the weak party’. 43

As an explanation for the approach assumed in the PICC, Bonell states that the reality presents professionals with different levels of education and technical preparation and ‘there are those who surrender to the temptation of taking advantage of the weaknesses and needs of others’. 44

It is likely that, in fact, such is the role that drafters wanted to give to good faith in the Principles, since Bonell writes authoritatively from his role in the working group in the preparation of the PICC. In addition, the official comment of article 1.7 states that, ‘A typical example of behaviour contrary to the principle of good faith and fair dealing is what in some legal systems is known as “abuse of rights”. It is characterised by a party’s malicious behaviour’.

However, that view, which points out good faith as a safeguard against the malicious behaviour that may pervade businesses, is not accepted in this thesis. This dissenting position is based on the reality of the lex mercatoria nowadays.

Firstly, there is an objective and simple way to test parties’ trustworthiness in international trade: in the societas mercatorum a merchant who behaves in bad faith will lose his reputation. According to Berger:

This requires a basic consensus of common values and convictions and the readiness of every member of that community to comply with the relevant rules and principles even at risk of losing and doing damage to individual interests … This is also true in international trade where the business persons’ consciousness of the validity of trade usages, customs, contract practices, and similar rules is guaranteed through ‘black lists’, withdrawal of membership rights, forfeiture of bonds, and similar dangers to the commercial reputation. 45

This aspect of reputation is key in the theory of good faith cooperation in the lex mercatoria, since the continuing interaction among traders – which

43 Galgano, La Globalizzazione nello Specchio del Diritto (n 15) 75.
44 Bonell, Un “Codice” Internazionale (n 42) 161.
implies the likelihood that the same merchants will deal again; the ability to recognize each other from the past; and to recall how the other has behaved until now – makes it possible for cooperation to be based on reciprocity and, therefore, to be stable.

One important aspect of reputation is to elicit cooperation, or to act as a deterrent to bad faith towards the other party. If one party has ‘historically’ behaved in good faith, there is a credible possibility that this party will not continue trading with a party who has not been in good faith in a particular contract. Of course, this has substantial consequences only in an ambit of durable or frequent interaction between traders – which is the actual situation of commerce in the ‘global village’ where long-term contracts proliferate. Here, Axelroad states that:

Ordinary business transactions are also based upon the idea that a continuing relationship allows cooperation to develop without the assistance of a central authority. Even though the courts do provide a central authority for the resolution of business disputes, this authority is usually not invoked … The fairness of the transaction is guaranteed not by the threat of a legal suit, but rather by the anticipation of mutually rewarding transactions in the future.

Secondly, arbitral awards analysed in this research demonstrate that traders are assuming spontaneously a position of cooperation. Such is, at least, the expected conduct. This is not a morality of abnegation, but a new

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47 See R Axelroad, *The Evolution of Co-operation* (Penguin, London 1990) 178-9. Axelroad began his project with the question: when should a person cooperate, and when should a person be selfish, in an ongoing interaction with another person? To solve this he used a particular kind of computer game called the Iterated Prisoner’s Dilemma. This project involved several game theorists coming from six countries. The winner of the two tournaments was a programme called TIT FOR TAT. TIT FOR TAT’s strategy is to start with cooperation, and thereafter doing what the other player did on the previous move. Axelroad considered that the qualities that made TIT FOR TAT successful in the tournaments would work in a world where any strategy was possible. The cooperation theory that is presented in this book is based upon an investigation of individuals who pursue their own self-interest without the aid of a central authority to force them to cooperate with each other. Among the conditions for cooperation to develop there is the need for an indefinite number of interactions and also the need for the players to remember how the two of them have interacted so far.
48 Justice of Appeal Priestley in an important Australian case: *Renard Constructions (ME) Pty v Minister for Public Works* (1992) 26 NSWLR 234, stated that, ‘People generally including judges and other lawyers from all strands of the community have grown used to the Courts applying standards of fairness to contract which are wholly consistent with the existence in all
approach to contract law, whose legal framework is the parties’ commitment to cooperate during the duration of the contract. As an example, in ICC award n. 10346 of the International Court of Arbitration in Barranquilla (Colombia) dated December 2000,\textsuperscript{50} two Colombian companies entered into a contract for the sale of electricity. The agreement was never fulfilled and the claimant sued the defendant for breach of contract and damages. The defendant objected that the contract was null and void for lack of registration in a Public Registry.\textsuperscript{51} This was invoked by the defendant/buyer in order to justify the non-performance of the contract. Naturally, the discussion was centred first on the validity. The tribunal considered the contract as valid.\textsuperscript{52} This award cites a judgement by the \textit{Consejo de Estado} (Council of State) Chamber for Administrative Disputes, which made the following comments on duty of responsibility: ‘It must be remembered that in state contracts the duties imposed on the parties have to be observed. They include the duty to act with sagacity which means with reasonable diligence’.\textsuperscript{53} The need to act with sagacity implies that a positive behaviour is required from the contractual parties, including the duty to cooperate with the other party’s fulfilment. The following part of the award places good faith as the tendency in international commerce nowadays:

It remains only to repeat for the sake of greater clarity in relation to the duty of collaboration, which is central to various parts of this Award, that academic opinion, case law and even legislation itself are paying increasing attention to the duties of correction and fair dealing or, to put it in another way, to the duty to act in accordance with the standards of good faith at all times.\textsuperscript{54}

\textsuperscript{48} Cf. Hyland (n 27) 545.
\textsuperscript{51} Called \textit{Sistema de Información Comercial} (Commercial Information System).
\textsuperscript{52} It was stated that there is a difference between substantive requirement for the validity of contract and administrative steps to be followed for its enforceability. Furthermore, the registration was regarded as a joint task of both parties, mainly based in the wording of the same agreement (clause 16.5). The underlying norms recalled for this purpose were: article 871 of the Commercial Code of Colombia and article 5.3 of the UNIDROIT Principles (in the 2004 version this is article 5.3.1).
\textsuperscript{54} Ibid 111.
Thirdly, to accept Bonell’s explanation implies arguing that a consumer-protective approach was adopted by the UNIDROIT Principles. Here, Dalhuisen states:

The UNIDROIT Contract Principles, which are limited to international commercial contracts, present in article 1.7 (2) a typical example of the use of consumer law or small companies’ protection in the professional sphere. It renders good faith generally as a mandatory concept, without explaining its role and meaning, and makes it compulsorily applicable even where it would not seem to appeal to higher overriding values. This would be unacceptable to common law lawyers and should also be to those of the civil law. Article 1.201 of the European Principles (which also covers consumer transactions but does not make proper distinctions either), can hardly be perceived as an established principle of commercial contract law as it pretends to be.\(^{55}\)

The following is the theory proposed here about the drafters’ option for such a meaningful involvement with good faith:

The answer can be found in the relationship between good faith and *pacta sunt servanda*. Contrary to what would appear to be the common belief, this Latin maxim was not formulated in Roman law, but by Samuel Pufendorf (1632-1694) who conceived the principle in the context of natural law and modern scientific method. Its immediate precedent is canon law, where the non-performance of a contractual obligation was considered a moral wrong.\(^{56}\)

At the time the maxim was formulated, it meant that agreements must be faithfully observed.\(^{57}\) Grotius (1583-1645) earlier also expressed this view in his renowned *De iure Belli ac Pacis*, ‘Nothing is so in harmony with the good faith of mankind as that persons should keep the agreements which they have made with one another.’\(^{58}\)

*pacta sunt servanda* became such a recognized principle, especially in civil law systems, that its inclusion in civil codes has been regarded as

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\(^{57}\) The translation for *pacta sunt servanda* by Mazeaud is: ‘The given word must be kept, the promise must be performed whatever it costs; *pacta sunt servanda*’. Henri Mazeaud, *Leçons de Droit Civil Obligations: Théorie Générale* (10th edn Montchrestien, Paris 1991) para 721.

\(^{58}\) H Grotius, *De Jure Belli ac Pacis Libri Tres* 2.11.1.4 1646 paraphrasing D. 2,14,1 pr. This was taken from F Kelsey (tr) (5th edn, 1925).
unnecessary. The establishment of *pacta sunt servanda* determined the importance given to good faith in the Principles. In plainer words, according to *pacta sunt servanda* agreements must be performed but, according to the Principles, they must be performed in good faith and fair dealing in international trade, *i.e.*, the parties are required to perform according to the particular circumstances and practices of the trade sector and the socio-economic environment of the contract. Therefore, good faith is a kind of restraint to the *pacta* principle today.

The philosophy of *pacta sunt servanda* is adopted in the UNIDROIT Principles. The logic that agreements must be performed allows the flow of commerce. The less obvious part is that they must be fulfilled according to good faith. Therefore, what the UNIDROIT Principles’ drafters made in article 1.7 was to state their commitment to good faith as a concept that allows judges and arbitrators to ensure that the parties’ responsibilities will be carried out and their mutual legitimate expectations will be met according to the special conditions of the contract in the international trade. This demonstrates that pragmatic is a feature attributable to good faith in the PICC.

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60 For example, article 6.2.1 of the PICC Contract to be Observed provides: ‘Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship’. Those are: articles 6.2.2 and 6.2.3.

61 Article 1.3 Binding Character of Contract: A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles.

62 Oliver Wendell Holmes’s logic – according to which there is no binding duty to perform and that the law only provides the solution for cases of breach – would terribly hinder international trade.

63 A Hartkamp in ‘Judicial Discretion under the New Civil Code of the Netherlands’ (1992) 40 Am.J.Comp.L. 551, 554-5 states: ‘The principle of bona fides or good faith (expressed by the complementary notions “reasonableness and equity”) has three functions: …Third, it has a “derogating” or “restrictive” function, … in that a rule binding upon the parties does not apply to the extent that, in the given circumstances, this would be unacceptable according to criteria of reasonableness and equity’.

64 See, as support for the theory offered in this thesis, the official comment of the Principles, number 3.
4.2.3.3 SUPPLETIVE CHARACTER OF GOOD FAITH

Apart from the central article 1.7, good faith is embraced in an explicit and also in an implicit way in other articles of the PICC.\textsuperscript{65}

Among the explicit norms: article 4.8 ‘Supplying an Omitted Term’ states that, ‘(1) Where the parties to a contract have not agreed with respect to a term which is important for determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied. (2) In determining what is an appropriate term regard shall be had, among other factors, to (a) the intention of the parties; (b) the nature and purpose of the contract; (c) good faith and fair dealing; (d) reasonableness’.

Undeniably, there is a similarity between this article and article 1135 of the French Civil Code that states: ‘Agreements are binding not only to what is expressed therein, but also to all the consequences which equity, usage or statute give to the obligation according to its nature’.

Article 4.8 is related to 5.1.2. ‘Implied obligations’: implied obligations stem from (a) the nature and purpose of the contract; (b) practices established between the parties and usages; (c) good faith and fair dealing; (d) reasonableness.

It has been said that article 5.1.2 is a nod towards the common law. However, it is expressly stated in the official comment of article 5.1\textsuperscript{66} that implied obligations are a corollary to good faith enshrined in art. 1.7 PICC.\textsuperscript{67}

\textsuperscript{65} Inter alia, articles 2.1.4. (2) (b); 2.1.15; 2.1.16; 2.1.18; 2.1.20; 3.8; 3.10; 5.1.2; 5.1.3; 5.2.5; 6.1.16 (2); 6.2.3; 7.1.6; 7.1.7; 7.2.2 (b) (c); 7.4.13; 9.1.3; 9.1.4 and 9.1.10.

\textsuperscript{66} In the 1994’s version of UNIDROIT Principles article 5.1 reads: ‘The contractual obligations of the parties may be expressed or implied’.

\textsuperscript{67} Bonell, The UNIDROIT Principles in Practice (n 17) 184. See ICC award n. 7365/FMS of 05.05.1997 Ministry of Defense and Support for the Armed Forces of the Islamic Republic of Iran v Cubic Defense Systems Inc (see n 20) where in order to justify the application by analogy of a ‘Termination for Convenience Clause’ to the contract as a result of changed circumstances, the arbitral tribunal applied Articles 5.1 and 5.2 [Arts. 5.1.1 and 5.1.2 of the 2004 edition] of the UNIDROIT Principles and the ‘widely accepted principles therein set forth regarding implied obligations’.
4.2.3.4 THE MEANING OF COOPERATION

Article 5.1.3 Cooperation between Parties reads as follows:

Each party shall cooperate with the other party when such co-operation may reasonably be expected for the performance of that party’s obligations.

The official comment on the Principles qualified the contract as, ‘not merely a meeting point for conflicting interests’ but also a common project in which each party must cooperate. This view is related by the same comment to the good faith principle.

Cooperation is inherent in the notion of good faith in transnational law. This is clear in the following statement contained in the preparatory work on the UNIDROIT Principles 2004: ‘It may be argued that since the UNIDROIT Principles expressly state the duty of the parties “[to] act in accordance with good faith and fair dealing in international trade” (Art. 1.7.(1)) and to cooperate with each other in the course of performance (Art. 5.3), no further provision(s) on waiver are needed’.68 The willingness of every member of the trade community to comply with the lex mercatoria implies that cooperation shall be undertaken to achieve the object of the contract. ICC award n. 9593 expressly states this, ‘Parties must cooperate in good faith in the course of performance in order to achieve their contractual purposes’.69

Federica Rongeat-Oudin and Martin Oudin have a narrow view of the lex mercatoria, i.e., they consider that only those principles and usages effectively applied by commercial operators are part of the lex mercatoria. However, these authors accept – in light of the positions taken in arbitral awards – that cooperation has been acknowledged as a duty derived from good faith and also that article 5.1.3 of the UNIDROIT Principles appears as a real restatement of international practice.70

The point made on the significant unity of criteria between national laws and the lex mercatoria as regards cooperation is neatly reflected in an award

68 UNIDROIT 1998 Study L – Doc. 55
70 F Rongeat-Oudin & M Oudin (n 14) 713.
of 2008 by the *Corte Arbitrale Nazionale ed Internazionale di Milano* where the arbitral tribunal based its decision primarily on Italian law (in particular on articles 1375 and 1226 of the Italian Civil Code as well as on relevant case law and legal writings), but also referred – as ‘a confirmation of the same principles at international level’ – to articles 5.1.3, 1.8 and 7.4.3 of the UNIDROIT Principles 2004.\(^7^1\)

### 4.3 PRINCIPLES OF EUROPEAN CONTRACT LAW

The Principles of European Contract Law (PECL) are framed in the context of the European harmonization of law.\(^7^2\) Thus, the first aim of these Principles is to serve as the model for a future European Code of Contracts.\(^7^3\) Complementary aims – until the Code is adopted – are to facilitate the interpretation and to fill the gaps in European harmonized and unified legislation in order to avoid the reference to particular national laws. Another no less important objective is, as with the UNIDROIT Principles, to be a guideline for national legislators who consider changing the contract law of their countries (in areas in which the EU will not legislate).\(^7^4\) Naturally, the Principles attempt to enclose those general principles and practices that form the *lex mercatoria* and to be available to arbitrators in a clear and ready-made form.

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\(^7^1\) The case is available (in Italian) at: <http://www.unilex.info/case.cfm?pid=2&do=case&id=1301&step=FullText> accessed 10 June 2011

\(^7^2\) They developed as the product of the work of a group of lawyers who in 1980 formed the Commission on European Contract Law (Lando-Commission) for the countries of the EEC. In 1989 the European Parliament passed a Resolution requesting a start to be made on the preparatory work on drawing up a European Code of Private Law.

\(^7^3\) The importance of the European Code as a stronger instrument in comparison with the ‘creeping harmonization’ of law made by erudite people is highlighted by Ole Lando in his ‘Principles of European Contract Law: An Alternative to or a Precursor of European Legislation’ (1992) 40 Am.J.Comp.L. 573.

\(^7^4\) Lando (n 73) 577 states: ‘In some EEC countries a revision of the law of obligations is being considered in connection with the making of a new civil code. The need to provide “European rules” would seem to be obvious for national legislators who are making rules which are intended to be durable and applied in a future when the European economic and political union will be much closer than now’.
Further on the issue whether PECL are a duplication of the PICC, the drafters of these instruments have argued in favour of their uniqueness but also admitted their duplication. In arbitral practice the PICC have been considered from the moment of their release, whereas on a number of occasions PECL have been dismissed in favour of the PICC.

The main features of good faith in this set of Principles and also a critical approach follow.

**4.3.1 GOOD FAITH IS ONE OF THE MAIN PHILOSOPHIES**

The Principles enshrine as the main guiding philosophies: freedom of contract and good faith and fair dealing.

The core norm is reflected in article 1:201 ‘Good Faith and Fair Dealing’:

(1) Each party must act in accordance with good faith and fair dealing;
(2) The parties may not exclude or limit this duty.

The following aspects should be considered for the imposition of number (2) of article 1:201.

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77 As of June 2007 the total number of arbitral awards and court decisions referring in one way or another to the UNIDROIT Principles reported in the UNILEX database <http://www.unilex.info> was 146. However, in actual fact at least the number of arbitral awards referring to the UNIDROIT Principles is likely to be much greater since most awards on account of their confidential nature remain unknown. Source of the numeral datum: M J Bonell, ‘Do We Need a Global Commercial Code?’ CISG Database, Pace Institute of International Commercial Law: <http://www.jus.uio.no/pace/do_we_need_a_global_commercial_code_michael.joachim_bonell/portrait.letter.pdf> accessed 2 June 2011.
78 See ICC award n. 12111 of 6 January 2003 which stated that PECL constitute an academic research, at this stage not largely well-known to the international business community, thus ‘Claimant's claim for application of the PECL is therefore rejected’. The arbitrator applied PICC instead. Available at: <http://www.unilex.info/case.cfm?pid=2&do=case&id=956&step=FullText> accessed 10 June 2011.
Firstly, the official comment declares that this article represents the ‘philosophy’ sustaining the net of other norms.\textsuperscript{79} Since good faith acts as the foundation of PECL, its mandatory character is clear.

Secondly, the purpose of the Principles is to serve as a model for a future European Code of Contracts, which shall be mandatory upon the parties. In this sense, number (2) appears completely justified.

The comment on article 1:102 contains an interesting assuagement to this mandatory rule: ‘What is good faith will, however, to some extent depend upon what was agreed upon by the parties in their contracts’. One is easily reminded of Section 1-302 of the UCC where standards of good faith can be fixed by the parties. This is a great tool in the parties’ hands. The following illustration may help to appreciate its importance:

A small stocking distributor in Chile contracts with a tights’ manufacturer in Italy, for the distribution of the Italian firm’s product in Chile. It is agreed that to comply with consumer protection rules the label with the specifications of care of the product should be in the Spanish language. The breach of this clause would make it impossible to distribute the product lawfully in Chile; therefore, the overlooking of this element by the Italian producer may entitle, by the parties’ agreement, the distributor to refuse performance, namely to reject delivery on the basis of lack of cooperation.\textsuperscript{80} By the parties’ stipulation the care instructions in a language other than Spanish amounts to a non-performance. Otherwise, this would not be considered a fundamental non-performance by the PECL.\textsuperscript{81}

\textsuperscript{79} Literally the comment reads: ‘This article sets forth a basic principle running through the Principles’.
\textsuperscript{80} Article 1:301 (4) of the PECL ‘non-performance’ denotes any failure to perform an obligation under the contract, whether or not excused, and includes delayed performance, defective performance and failure to cooperate in order to give full effect to the contract.
\textsuperscript{81} Cf. articles: 8:103 Fundamental Non-Performance; and 7:110 Property not Accepted of the PECL. In a German case, the Swiss defendant argued that goods were delivered by the German plaintiff with instructions booklets in German but not in other languages spoken in Switzerland. As regards this allegation, the court found that the appliances (object of the contract) had not been produced specifically for the Swiss market. Therefore, the delivery of instruction booklets in French and Italian had to be stipulated. Germany 9 May 2000 District Court of Darmstadt <http://cisgw3.law.pace.edu/cases/000509g1.html> accessed 23 July 2011.
The content of good faith may diverge widely according to the economic sector and to the particular circumstances of the contract; therefore, it is important for the parties to have an alternative to establish with clarity the idea of good faith embraced in their agreement. In addition, this is an excellent guidance for judges and arbitrators.

### 4.3.2 GOOD FAITH IS AN INSTRUMENT IN THE INTERPRETATION AND INTEGRATION

In its role of essential principle, good faith is offered as an instrument for interpretation. Article 1:106 states:

(1) These Principles should be interpreted and developed in accordance with their purposes. In particular, regard should be had to the need to promote good faith and fair dealing, certainty in contractual relationships and uniformity of application.

To use good faith as an element of interpretation of the PECL it is important to understand the meaning of good faith. The official comment states that ‘good faith’ means honesty and fairness in mind, whereas ‘fair dealing’ means the observance of fairness in fact, which is an objective test.

There are other provisions that stress good faith’s role in the interpretation and integration of the contract in PECL. Among them is article 5:102 ‘Relevant Circumstances’. In paragraph g) this article states that good faith and fair dealing are to be taken into account in the interpretation of the contract.

In the task of integration of the contract the arbitrator is guided by article 6:102 Implied Terms: ‘In addition to the express terms, a contract may contain implied terms which stem from: (c) good faith and fair dealing’.

The arbitrator’s task of integration of the contract governed by the lex mercatoria is one of incredible delicacy, because the lex mercatoria is based

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82 Here, the role of good faith is the same as in the scheme used by Roman jurists in the formulary process, where good faith acted ‘adiuvandi, suppleendi or corrigenda gratia’. The citation is from Pap. D 1,1,7,1. See F Wieacker, El Principio General de la Buena Fe (Editorial Civitas, Madrid 1982) (Original title: Zur rechtstheoretischen Präzisierung des §242 BGB) 50.
on the *opinio iuris atque necessitatis*, that is, the persuasion in the community of traders about the necessity of the rule. Therefore, the arbitrator in integrating the contract applies good faith in order to make effective the will of the parties, the requirements of justice and what is generally accepted as binding by traders.

Further to the power of arbitrators shaping good faith within the lex mercatoria, a reference must be made to the harsh posture of Critical Legal Studies’ authors (CLS). Here, this radical thesis challenged the very existence of legal rules, at least when they were thought of as capable of constraining and channelling individual behaviour. This was an early and undeveloped form of the instrumentalist view of rules, *i.e.*, the employment of the rule as a tool to produce the desired effect. According to this position, it was not the rule that exercised power but the judge who exercised power and who used the rule both to help him do it and to hide the fact of his power. This criticism is based on the denying of the rule of law as such. This school of thought postulates that to the existence of the rule of law compatible with essential liberties of humankind there must be complete separation between morals, politics and the rule of law; but, in fact, there is no such separation. However, this criticism loses its strength in the lex mercatoria, since it is made by rules not imposed but created and accepted by the same traders; (another point made by CLS’s authors is the distorted idea of legitimacy of law only if is made by government, not people). Therefore, the arbitrator has no reason to hide anything, since the power exercised by this expert is derived from the same receivers of the award.83

4.3.3 GOOD FAITH IS LINKED TO REASONABLENESS

Good faith is linked with reasonableness all through the Principles, for example in articles 1:302, 5:101 (3), 2:202 (3) (c) or 8:103 (b). The main rule reads as follows:

Article 1:302 Reasonableness
Under these Principles reasonableness is to be judged by what persons acting in good faith and in the same situation as the parties would consider to be reasonable. In particular, in assessing what is reasonable the nature and purpose of the contract, the circumstances of the case, and the usages and practices of the trades or professions involved should be taken into account.

Reasonableness provides the ‘yardstick’ for cases in which the strict application of a rule could amount to an unjust result.

Reasonable means what is rational, given the intended purpose of the agreement. Rational means what is appropriate in the light of the available knowledge.

The official comment of the PECL offers a good illustration of what is rational:

Constructor C, whose employees have fallen ill in great numbers, has asked Owner O for the time agreed for C’s completion of O’s liquor store to be extended by one month. O has refused to grant the extension. After that a licence to sell liquor which O expected to get as

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84 Other norms related with reasonableness:
Article 6:101 Statements Giving Rise to Contractual Obligations: (1) A statement made by one party before or when the contract is concluded is to be treated as giving rise to a contractual obligation if that is how the other party reasonably understood it in the circumstances, taking into account:
(a) the apparent importance of the statement to the other party;
(b) whether the party was making the statement in the course of business; and
(c) the relative expertise of the parties.
Article 6:104: Determination of price: Where the contract does not fix the price or the method of determining it, the parties are to be treated as having agreed on a reasonable price.
a routine matter is held up due to a long lasting strike among civil servants which means that O will not be able to use the building until three months after the agreed completion time. Good faith requires that O notifies C that it will not need to have the building completed on time.

Fairness suggests in this case that, as O will not suffer loss because of third party action, it should not be able to get contractual remedy for what would otherwise be a contractual breach by C, because there is no loss.

The same perspective is taken in the rule contained in article 9:505 on Reduction of Loss:

(1) The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party could have reduced the loss by taking reasonable steps;
(2) The aggrieved party is entitled to recover any expenses reasonably incurred in attempting to reduce the loss.

This solution is expressly accepted in some national regulations, namely: §1304 ABGB (1811); §254 BGB (1900); article 44 Swiss Code of Obligations (1911); article 1227 Italian Civil Code (1942); article 6:101 Dutch Civil Code (1992); article 1479 Civil Code of Quebec (1994); and also article 7.4.8. UNIDROIT Principles. In all these cases, the rule is derived from good faith. The precedent at international level is represented by article 77 CISG.86

4.3.4 GOOD FAITH AND COOPERATION: A NECESSARY SYNTHESIS

Article 1:202 Duty to Co-operate states: ‘Each party owes to the other a duty to co-operate in order to give full effect to the contract’.

In civil law countries cooperation is regarded as a duty derived from good faith. According to the official comment on article 1:202, in common law tradition good faith is usually an implied term that has not had much

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86 The logic, as it links to mitigation, can also be seen in common law case-law. See H G Beale (ed), *Chitty on Contracts* Vol.1 (29th edn Sweet & Maxwell, London 2004) 1478 ff.
application. On the contrary, it has been postulated in this thesis – based on judicial decisions – that English courts recognize in commercial contracts the purpose that good faith attempts to accomplish, identifying it with cooperation between the parties. Therefore, this concept of good faith cooperation is not an exclusive idea of the civil law tradition.

In the Principles cooperation is presented as an autonomous duty. However, the general nature of the terms used to define the duty of cooperation and the illustrations provided in the official comment on the Principles allow equating cooperation with good faith. Article 16:102 puts on the same stand good faith, fair dealing and cooperation.

Article 16:102 Interference with Conditions
1) If fulfilment of a condition is prevented by a party, contrary to duties of good faith and fair dealing or co-operation, and if fulfilment would have operated to that party’s disadvantage, the condition is deemed to be fulfilled.
2) If fulfilment of a condition is brought about by a party, contrary to duties of good faith and fair dealing or co-operation, and if fulfilment operates to that party’s advantage, the condition is deemed not to be fulfilled.

The following illustration of a resolutive condition being treated as having been fulfilled demonstrates that good faith is conceived as cooperation:

When farmer H’s tractor is stolen, he hires from O, another farmer, a replacement tractor. As a favour to H, the rate of hire is below the market rate. O’s obligation to make the tractor available is subject to the resolutive condition that it is to come to an end if H acquires a new tractor to replace the stolen tractor. H turns down an attractive offer of a replacement tractor made by T in order to continue benefiting from the favourable rate of hire. The condition is deemed to be fulfilled when H ought to have accepted T’s offer.

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87 See Chapter Two, Section 2.5.2.
Good faith is the main philosophy of PECL, therefore cooperation is regarded as essential in these Principles. Hence, article 1:301 (4) states that the failure to co-operate amounts to non-performance. In addition, according to the comment on article 1:201, good faith is required during the formation, performance and enforcement of the parties’ duties under the contract.

4.4 DRAFT OF THE COMMON FRAME OF REFERENCE (DCFR)

The Draft of the Common Frame of Reference (DCFR) is the result of a process initiated in 2001 with the Communication on European Contract Law.\(^{89}\) In 2005 several groups of academic researchers were commissioned by the European Commission to contribute to the DCFR.\(^{90}\) The research work finished in 2008 and led to the publication of the academic Draft of the Common Frame of Reference (DCFR),\(^{91}\) which includes principles, definitions and model rules of European private law, including contract and tort law. It contains provisions for both commercial and consumer contracts.\(^{92}\) The future ‘political’ Common Frame of Reference (CFR) will be restricted to transactions in Europe, whether they have a cross-border dimension or not.

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\(^{90}\) Two groups were contracted to produce a DCFR: the ‘Study Group on a European Civil Code’ and a group who undertook to work specifically on the relevant acquis (the French term acquis communautaire refers to the rights and obligations deriving from EU treaties, laws, and regulations). They were granted academic independence throughout the process. Other groups were also commissioned with specific purposes: a group of predominantly French scholars to work on terminology and the philosophical underpinnings of the project (called ‘Association Henri Capitant and Société de Législation Comparée’) and the ‘Trento/Torino Group’ working on the common core of European private law (see: www.common-core.org). Stakeholders and other experts throughout the continent were also consulted during the elaboration of the DCFR.

\(^{91}\) C Von Bar, E Clive and H Schulte-Nölke (eds), Principles, Definitions and Model Rules of European Private Law; Draft Common Frame of Reference (DCFR) (Sellier, Munich 2009). At p. 6 it is stressed that this is ‘an academic, not a politically authorised text’.

\(^{92}\) The DCFR includes business-to-business transactions, business-to-consumer and consumer-to-consumer contracts (b2b, b2c and c2c, respectively).
Due to the intention of the drafters to incorporate the current and/or the best rules for every case, the DCFR contains many solutions taken from the lex mercatoria based on good faith. In fact, the Draft includes at least forty references to this principle. These references seem to be the Achilles’ heel of the Draft for its recognition and enforcement, especially to England. Here, Vogenauer points out the lack of precision of the Draft due to a great number of open-textured provisions; he adds that it has been much attacked for its lack of determinacy and guidance which is said to lead to a massive expansion of judicial power.

According to a document published by the House of Lords Select Committee on the European Union Committee 2008-2009, there are serious concerns on the English side, namely:
- The broad scope of the DCFR, which covers, not only matters considered as falling within the general law of contract by practitioners of English law but also, contracts for the sale of goods, financial securities, intellectual property rights and software, and unjustified enrichment.
- The most rigorous observations point out the differences between the common law and other national laws. The solutions adopted are regarded as differing significantly from the current law of contracts in England and Wales. It is considered that the DCFR raised major philosophical problems. Regarding specific areas of difference the big issue is good faith. In the Report this theme falls under the heading ‘Party autonomy and contractual certainty’. It is considered that the DCFR involves too much discretion, and so uncertainty, by the use of ‘an astonishing number of vague and ambiguous terms, concepts such as “reasonableness” and “good faith”’. It is said, ‘In contrast to English contract law, the DCFR contains an overarching principle of good faith and fair dealing, which applies to the process by which a contract

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93 Similar to article 7 of CISG, article 1:102 of the DCFR provides that in the interpretation and development of its provisions, ‘regard should be had to the need to promote: (a) uniformity of application; (b) good faith and fair dealing; and (c) legal certainty’.


is brought into being as well as to the performance of contractual obligations'.

This position could seem to demolish the theory proposed in this thesis about the new approach of English jurists to good faith in commerce. However, it is submitted here that this harsh position is determined from the mixture of consumer law and business-to-business rules in one instrument. This could lead to the imposition of unnecessary protective norms on merchants for their vis-à-vis agreements.

4.4.1 LATEST DEVELOPMENTS: THE GREEN PAPER FROM THE EU COMMISSION ON POLICY OPTIONS FOR PROGRESS TOWARDS A EUROPEAN CONTRACT LAW FOR CONSUMERS AND BUSINESSES

Currently the Law Commission is working on policy options for progress towards a European Contract Law for consumers and businesses. With this objective, a Green Paper was launched on the 1st July 2010, proposing a consultation to gather views from relevant stakeholders on the options in the area of unification of European contract law. Depending on the results, the Commission could propose further action by 2012.

The Green Paper proposes several alternatives about the instrument of European contract law:
Option 1: Publication of the results of the Expert Group;
Option 2: An official ‘toolbox’ for the legislator;
Option 3: Commission Recommendation on European Contract Law;
Option 4: Regulation setting up an optional instrument of European Contract Law;
Option 5: Directive on European Contract Law;

96 Ibid 13.
98 The consultation ran until 31 January 2011.
Option 6: Regulation establishing a European Contract Law; Option 7: Regulation establishing a European Civil Code.

In order to carry out its mandate, the Commission has set up an Expert Group\textsuperscript{101} to study the feasibility of a user-friendly instrument of European contract law. The Group will assist the Commission in selecting those parts of the DCFR related to contract law and in improving the selected provisions. It will also take into account other relevant sources in the area and, of course, the results of this consultation, which closed on 31 January 2011.

On 3 May 2011 the feasibility study on a potential European contract law instrument was published.\textsuperscript{102} All interested parties were entitled to send their feedback on the individual articles in the study until 1 July 2011. As stated, the next step for the European Commission will be to prepare a political initiative taking into account the feasibility study by the Expert Group, feedback on the study and the result of the aforementioned consultation on a European Contract Law.

At the present stage, the following aspects can be asserted:

- There is a lot of scepticism in the stakeholders, especially those representing big companies;
- The support for this initiative varies according to the industrial sector, for example, there is an ample support by the insurance sector;
- Options 6 and 7 have been ruled out as a possibility due to absolute lack of support, that is to say, real harmonization is excluded. The most possible alternatives are option two, \textit{i.e.}, ‘toolbox’ and option four, \textit{i.e.}, an optional instrument.\textsuperscript{103}

\textsuperscript{102} See the Publication of the results of the feasibility study carried out by the Expert Group on European contract law for stakeholders’ and legal practitioners’ feedback at: <http://ec.europa.eu/justice/policies/consumer/docs/explanatory_note_results_feasibility_study_05_2011_en.pdf> accessed 6 July 2011.
\textsuperscript{103} Information obtained at the British Institute of International and Comparative Law Conference, ‘The Optional EU Contract Law Instrument – What to Expect?’ (7 February 2011).
4.4.2 THE QUESTION IS: WHAT IS IT THEY ARE LOOKING FOR?

The instrument used by the EU Commission as the basis for its proposal is the Draft CFR, which is an academic work, reflecting only in part the common practices currently applied. The topical issue is whether it will be effectively applied by all the addressees – though some norms are not according with their own tradition – or whether it will serve as a mere inspiration. According to the replies received, it seems that the more probable is the last alternative.\textsuperscript{104}

Here, a great flaw is revealed: the lack of aim of this instrument in commercial and consumer areas. If it is to be used as a ‘toolbox’ by commercial agents, there are already others instruments fulfilling the same role, for example PICC. In addition, what is currently clear is that big companies are those less supportive of this initiative. This could result in the fact that the instrument is limited to consumers and SMEs; and for contracts between these kinds of stakeholders there is the Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market.

The question is: how to overtake the deficiencies detected by the English position, which in short proposes that, the more open terms are used the less harmonization is attainable? As regards good faith, the solution would be to state in the same instrument (or in its official comments) how the principle must be interpreted when it is applied. This thesis might be a useful resource to the Commission; the current common understanding of good faith cooperation could be offered to the trading community as a way to harmonize on this general principle.

\textsuperscript{104} The reason adduced to opt for a toolbox is that in the search for the best practices no constraint is preferable.
4.5 OHADA

4.5.1 GENERAL NOTIONS

Among those manifestations of the lex mercatoria outside Europe an interesting case is the Organization for the Harmonization of Business Law in Africa (with its French acronym OHADA).

Article 1 of the Treaty of Port Louis (Mauritius) of 17 October 1993 that created the Organization establishes:

The objective of the present Treaty is the harmonisation of business laws in the Contracting States by the elaboration and adoption of simple modern common rules adapted to their economies, by setting up appropriate judicial procedures, and by encouraging arbitration for the settlement of contractual disputes.

OHADA seeks for the integration of laws in different areas of the economical spectrum. The OHADA framework currently regulates eight areas of business law – commercial law, corporate law, security, debt recovery and enforcement, bankruptcy, arbitration, accounting and the law regulating contracts for the carriage of goods by road. There are plans underway to harmonize other areas including competition law, intellectual property law, banking law, labour law, evidence and contract law.

Based on the experience of OHADA, in the Conference of 15 May 2007 in Pointe à Pitre, Guadeloupe the OHADAC project was created. OHADAC is the acronym for the Organization for the Harmonization of Business Law in the Caribbean. This project is in an incipient stage at the moment, despite the fact that a number of conferences and seminars have taken place supporting the initiative. For example, a Statement by the Latin American and Caribbean Congress of International Commercial Arbitration in Havana was signed in June 2010 for the promotion of the OHADAC project. The site of the Project is: <http://www.ohadac.com/home.html> accessed 3 June 2011.

The OHADA Treaty is made up today of 16 Africans states: Benin, Burkino Faso, Cameroon, Central African Republic, Comoros, Congo, Ivory Coast, Gabon, Guinea, Equatorial Guinea, Guinea Bissau, Mali, Niger, Senegal, Chad and Togo. Initially fourteen African countries signed the treaty, with two countries subsequently adhering to the treaty (Comoros and Guinea) and a third (Democratic Republic of Congo) due to join shortly. Article 53 of the OHADA Treaty provides that any Member State of the African Union may become a member. An impediment the Organisation confronts is the diversity of family legal traditions present in the sub-region (West and Central African States) with common and civil law jurisdictions. It is difficult to bring Anglophone West Africa into OHADA’s projects because of the perceived civilian nature of its legal thought. The other concern is the diversity of languages: English, French, Spanish and Portuguese. An example that can illustrate this situation is Cameroon,
OHADA establishes the supremacy and direct effect of the OHADA uniform laws; however it still provides member states with a flexible and modern approach which can be adapted to each country.

Furthermore, the objective of OHADA to promote African economic integration and attract investment to the region is pursued through the establishment of a Common Court of Justice and Arbitration. This mechanism provides a trustworthy way to settle disputes relating to the application and interpretation of the uniform acts by different national courts.

4.5.2 DRAFT OHADA UNIFORM ACT ON CONTRACT LAW

The preliminary Draft OHADA Uniform Act on Contract Law has been prepared by Fontaine in line with the UNIDROIT Principles of International Commercial Contracts.\(^{108}\)

The Act deals with good faith from the point of view of the protection of the weaker party, since it is assumed that inequalities of bargaining power exist also in business relationships.\(^{109}\) This view is based on Fontaine’s preliminary work for the elaboration of the Draft: he carried out interviews, questionnaires and visits to the numerous African countries involved. The key question in the questionnaire was:

The UNIDROIT Principles set great store by good faith (art. 1.7) and some of its consequences: the duty to collaborate (5.3), mitigation of harm (art. 7.4.8), penalties for negotiating in bad faith (art. 2.1.15). Should this approach, so typical of recent trends in international commercial law, be retained in the OHADA draft?\(^ {110}\)

which is both Anglophone and Francophone. It is probable that before the Anglophone part joins, the existing Uniform Acts may need some readjustment to reflect the legal tradition of the joining group. See S Kofi Date-Bah, ‘The UNIDROIT Principles of International Commercial Contracts and the Harmonisation of the Principles of Commercial Contracts in West and Central Africa’ (2004) 9 Unif.L.Rev. 269.


\(^{110}\) Ibid 662.
The countries which are the heirs of the civil law tradition are used to having good faith in the performance of the contract. The issue was whether they were prepared to enshrine good faith as a general principle in the different phases of the contract, because that is the way the UNIDROIT Principles embrace it. On this point opinions were almost uniformly positive.\textsuperscript{111}

However, as regards good faith in the case of change of circumstances and its consequences, the renegotiation of the contract, opinions were not unanimously favourable. Some (most of them still treasuring the precedent of the French law) consider that that could bring more uncertainty than the instability it intended to solve. Yet the view adopted by the Act was to incorporate renegotiation, including safeguards, to avoid improper use. Here, Article 6/22: ‘Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions…’

The position of the majority in favour of the inclusion of renegotiation has prevailed, since it was considered that such a provision is beneficial for the unstable climate that characterizes Africa today.\textsuperscript{112}

Renegotiation takes place in the case of hardship. Hardship is a novelty introduced in international commercial contracts by UNIDROIT, complementing the gap left by the United Nations Convention on Contracts for the International Sales of Goods 1980.\textsuperscript{113} The rule of the UNIDROIT Principles governing the issue is article 6.2.2 Definition of Hardship:

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{111} Furthermore, two thirds of those interviewed and Fontaine himself are in favour of extending the scope of this Act to all contracts without distinction, that is to say, a unified Act covering both civil (non-commercial) and commercial contracts. In fact, the Preliminary Draft makes an \textit{a priori} case for a unified Act. In favour of the unification of civil and commercial obligations, see: L Carvajal, ‘La Unificación del Derecho de las Obligaciones Civiles y Comerciales’ (2006) 27 Revista de Derecho de la Pontificia Universidad Católica de Valparaíso 37.
\item \textsuperscript{112} As regards renegotiation, Park in \textit{Arbitration of International Business Disputes} (OUP, Oxford 2006) 543 states that, ‘ICC arbitrators are not anxious to give the proverbial “pound of flesh”. They find the \textit{pacta sunt servanda} principle to be tempered by another rule; that of good faith’. Furthermore, Carbonneau in ‘A Definition of and Perspective upon the Lex Mercatoria Debate’ in T Carbonneau (ed), \textit{Lex Mercatoria and Arbitration} (Kluwer Law International, London 1998) 18, points out that, ‘The duty to renegotiate reflects the most innovative feature of rule creation through ICC arbitral adjudication’.
\item \textsuperscript{113} The United Kingdom has not yet ratified CISG, therefore UNIDROIT Principles are a useful international body of rules (not binding) to be applied in international contractual matters. See an explanation of this reluctance in A F M Maniruzzaman, ‘Formation of International Sales Contracts: A Comparative Perspective’ (2001) 29 IBL 483.
\end{itemize}
\end{footnotesize}
There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party’s performance has increased or because the value of the performance a party receives has diminished, and
(a) The events occur or become known to the disadvantaged party after the conclusion of the contract;
(b) The events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
(c) The events are beyond the control of the disadvantaged party and;
(d) The risk of the events was not assumed by the disadvantaged party.

The cause of hardship is the new circumstances that make the contract more onerous. As a result, the debtor desires to be relieved from an extremely onerous obligation. In order to renegotiate the cooperation of the creditor is needed. Here, the concept of cooperation includes giving all reasonable support to the debtor when new unexpected circumstances occur. In support of this view, there is the commentary of article 6.2.2 (Definition of Hardship) of the PICC:

A contract is not merely a meeting point for conflicting interests but must also, to a certain extent, be viewed as a common project in which each party must cooperate. This view is clearly related to the principle of good faith and fair dealing (Art. 1.7) which permeates the law of contract, as well as to the obligation to mitigate harm in the event of non-performance (Art.7.4.8).

Finally, it is worth stressing that the inclusion of renegotiation in the Draft OHADA Uniform Act on Contract Law means that good faith is regarded as an element that can bring about certainty instead of uncertainty – the latter is the feature given to it by the orthodox doctrine in English law.
4.6 INTER-AMERICAN CONVENTION ON THE LAW APPLICABLE TO INTERNATIONAL CONTRACTS

It was stated in Chapter Two that the apogee of the lex mercatoria had already begun in the Americas with the Inter-American Convention on the Law Applicable to International Contracts (Mexico 1994).\(^\text{114}\) It is important to understand this Convention in its context.

From the last decades of the nineteenth century the process of codification of international private law has been a permanent activity in the Inter-American context. This process has assumed different institutional forms.\(^\text{115}\) Currently, it takes the form of Inter-American Specialized Conferences on Private International Law, known by its acronym in Spanish CIDIP (Conferencias Especializadas Interamericanas sobre Derecho Internacional Privado).\(^\text{116}\)

The first CIDIP occurred in Panama in 1975. From the very beginning of the process of codification of international private law the experts have followed two criteria:

- A general focus, in other words, a code that should embrace all the norms;
- A gradual and progressive process, which implies the formulation of international instruments on particular subjects.

The latter criterion, \textit{i.e.}, codification by sector has been carried out by CIDIP.\(^\text{117}\)

CIDIP are distancing themselves from the traditional approach of international private law for the solution of conflicts of law; instead, they are


\(^{115}\) The first treaty on this field was adopted in Montevideo, Uruguay in 1889. Another example is the famous Bustamante Code in 1928.

\(^{116}\) The Charter of the Organization of American States (OAS) defines CIDIP as ‘Intergovernmental meetings to deal with technical matters or to develop particular aspect of Inter-American cooperation’.

\(^{117}\) At the moment six CIDIP have been held, which have produced 26 Inter-American Instruments (20 Conventions, 3 Protocols, 1 Model Law and 2 Uniform Documents) on the following general subjects: judicial cooperation between Inter-American States and legal certainty in cross-border transactions in civil, family, commercial and procedural relationships. In spite of this variety of topics, the member States tend clearly to deal in future CIDIP with aspects relating to mercantile law, international commerce and economic law. In fact, the themes chosen for the future VII CIDIP are: consumer protection and electronic-secured transactions registries.
procuring the regional harmonization of laws (especially from the VI CIDIP onwards). This is a sign of a universal trend, as it has been already seen here.\textsuperscript{118}

For the purpose of this thesis, the important CIDIP is the fifth because of its outcome: the Inter-American Convention on the Law Applicable to International Contracts, signed in Mexico the 17 March 1994.

Article 9 (2) of the Inter-American Convention on the Law Applicable to International Contracts provides that, ‘If the parties have not selected the applicable law, or if their selection proves ineffective, the contract shall be governed by the law of the State with which it has the closest ties’.

Regarding the way to establish the State with which the contract has the closest ties, the Inter American Convention differs from the Rome Convention on the Law Applicable to Contractual Obligations (1980). The latter contains the presumption that, ‘The contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration’ (article 4). However, article 9 of the Inter-American Convention opted for a completely new approach:

The Court will take into account all objective and subjective elements of the contract to determine the law of the State with which it has the closest ties. It shall also take into account the general principles of international commercial law recognized by international organizations.

This provision allows the arbitrator to take into consideration elements that could be even more crucial than the ‘characteristic performance’ to establish the applicable law in the contract concerned; among those elements, general principles of international commercial law – such as good faith – are included. This reference is completed with article 10 of the Convention:

\textsuperscript{118} Following the steps of OHADA, the General Assembly of OAS has requested the General Secretariat to explore ways of collaboration with international organizations, such as UNCITRAL, UNIDROIT and BID (Inter-American Bank of Development). Further information is available on <http://www.oas.org/dil/private_international_law.htm> accessed 3 June 2011.
In addition to the provisions in the foregoing articles, the guidelines, customs, and principles of international commercial law as well as commercial usage and practices generally accepted shall apply in order to discharge the requirements of justice and equity in the particular case.\(^{119}\)

This is a call to apply the lex mercatoria to the substance of the dispute. Such applicability by virtue of the Mexico Convention means a departure from the Rome Convention which does not permit the application of a law that is not the state one.

It is extremely important to note that the ratification of this Convention implies that arbitrators as well as national judges can apply the lex mercatoria, ‘National judges are well advised to make an effort in order to unify the interpretation of these two Conventions (Mexico and Rome Conventions), since this is a mandatory requirement of international commerce’ (parenthesis added).\(^{120}\)

According to this thesis, good faith in the lex mercatoria is understood as cooperation; therefore, the fundamental point to consider is the nature of the encounter between this concept and those enshrined in Inter-American contexts. Is there homogeneity? Is there a fundamental difference between good faith in the lex mercatoria and concepts already embraced in national laws of this area? Is there willingness to evolve to this new harmonized concept of good faith?

It is possible to state from the beginning that good faith as a general principle is not a strange element to the United States – which recognizes good faith as a general principle, as we have already seen – and to Latin American countries – which belong to the civil law tradition. Brazil and

\(^{119}\) According to Siqueiros, ‘This provision was suggested by Gonzalo Parra Aranguren, President of the Venezuelan’s delegation’. J L Siqueiros, ‘Los Principios de UNIDROIT y la Convención Interamericana sobre el Derecho Aplicable a los Contratos Internacionales’ (1998) 27 Estudios de Derecho Internacional Público Universidad Nacional Autónoma de México 217.

\(^{120}\) A Boggiano, ‘La Convention Interaméricaine sur la Loi Applicable aux Contrats Internationaux et les Principes d’UNIDROIT’ (1996) 1 Unif.L.Rev. 219, 227. Here Boggiano holds that UNIDROIT Principles can flesh out articles 9 (2) and 10 of the Inter-American Convention and also makes a plea that the progress represented by the Mexico Convention should not be hindered by the application of the rules of the forum.
Argentina, for instance, recently incorporated the concept into their civil law codes, but previously it was part of the legal culture.\textsuperscript{121} Other countries such as Chile, Colombia, El Salvador and Ecuador have always embraced good faith in their civil codes.

Further to the meaning of cooperation assigned to good faith in international commercial law, it is submitted here that this is not far from what national spheres embrace. Brazil, for instance, incorporated ‘Objective Good Faith’ in the new Civil Code of 2002.\textsuperscript{122} Objective good faith is enshrined by article 422 of the Code as a norm of conduct meaning loyalty and honesty to be observed by the parties to a contract. This way of understanding was previously enshrined by the consumer protection code.\textsuperscript{123} However, the Code of 1916 (old Civil Code) only had references to subjective good faith. Objective good faith is one of the bases of the new contractual order of the Code; the other basic principles are the social function of contracts and equity.\textsuperscript{124}

Teresa Negreiros assigned to objective good faith in the Brazilian Civil Code the main function of link between private relations and constitutional regulations. Negreiros placed good faith within the frame of the constitutional general clause on people’s protection. Since the fundamental objective of the Republic is the construction of a society that shows solidarity, where the respect for the other is an essential element of every legal relation, she regards good faith as part of the substratum of the contract understood as a relationship of cooperation.\textsuperscript{125}

\textsuperscript{121} Good faith is enshrined in different ways in the Latin American codes. The principle is assuming a great role in Argentina where it was officially incorporated into the code by Act 17.711 of 1968, and included in the phase of negotiation in the Unified Draft of Civil and Commercial Code, articles 1158 and 1159. In any case, legal scholars always affirmed the integrating role of good faith.

\textsuperscript{122} The new Civil Code of Brazil was introduced by Act n. 10.406 of 10/01/02. The Code was effective from 12/01/2003.

\textsuperscript{123} Brazilian author Claudia Lima Marques in \textit{Contratos no Código de Defesa do Consumidor} (3rd edn Revista dos Tribunais, São Paulo 1999) 106 states: ‘Objective good faith means a “reflected” behaviour, behaving and thinking of the other party, respecting its legitimate interests, its reasonable expectations and its rights; acting loyally, not abusing, not obstructing, not harming or causing excessive disadvantage, cooperating to attain the contractual purpose and the fulfilment of the parties’ interests’.

\textsuperscript{124} See L De Faria Beraldo, \textit{La Função Social do Contrato – Contributo para a Construção de uma Nova Teoria} (Editora del Rey, Belo Horizonte 2011).

\textsuperscript{125} M C Pereira Ribeiro and R C Steiner, ‘O Paradigma da Essencialidade nos Contratos: Recensão da Obra de Teresa Negreiros’ (2008) 4 Revista Direito Getulio Vargas São Paulo
As regards the willingness of Inter-American countries to accept the lex mercatoria and its principles – good faith specifically –, it is possible to state that at the moment the scope of the Inter-American Convention on the Law Applicable to International Contracts is restricted to a small number of signatory countries: Bolivia, Brazil, Mexico, Uruguay and Venezuela. Yet the lex mercatoria is being applied by other means in several countries. Many Latin-American Arbitral Centres, for example, have taken steps forward to internationality, incorporating the lex mercatoria as a possibility for the resolution of international disputes. In Chile, for instance, the ‘Centre of Arbitration and Mediation’ (Centro de Arbitraje y Mediación) explicitly provides that the controversy can be solved by general principles of law or the lex mercatoria. Likewise, the Rules of Arbitration of the ‘Arbitration Center of Mexico’ (Centro de Arbitraje de México) adopted the generic term ‘rules of law’ instead of ‘state law’. In Argentina the parties can choose the application of the lex mercatoria; according to article 68 of the Arbitration Rules of the Stock Exchange Market of Buenos Aires (Bolsa de Comercio de Buenos Aires) the parties are allowed to decide the substantive juridical norms applicable to the case.


126 Some States that have failed to ratify CIDIP instruments have nevertheless used those instruments as models for domestic legislations. See Carlos Manuel Vázquez, ‘Regionalism versus Globalism: A view from the Americas’ (2003) 8 Unif.L.Rev. 63.


128 Article 23 of the Rules of Arbitration of the ‘Arbitration Center of Mexico’ states: Applicable Rules of Law
1. The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law that it determines to be appropriate.
2. In all cases, the arbitral tribunal shall take into consideration the provisions of the contract and the trade usages.

<http://www.camex.com.mx/english/reglasdearbitraje-i.pdf> accessed 16 July 2011. Cf. ICC Rules of Arbitration article 17 (1) which provides: ‘The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate’.

129 The Spanish text of article 68 reads: El Tribunal decidirá el litigio con arreglo a las estipulaciones del contrato, tendrá en cuenta los usos y costumbres mercantiles y:

a) en el arbitraje de derecho, aplicará las normas jurídicas elegidas por las partes. Si éstas no indicaren la ley aplicable, se aplicará la que determinen las normas de conflictos de leyes. Se entenderá que la indicación del derecho de un Estado se refiere al derecho sustantivo y no a las reglas de conflict de leyes, a menos que las partes expresaren lo contrario;

b) en el arbitraje de amigables componedores, decidirá con fundamento en equidad (emphasis added).
In conclusion, in practice national jurists from the Inter-American region are applying good faith in the context of the lex mercatoria.130

4.7 THE IMPACT OF INTERNATIONAL INSTRUMENTS

It is important to examine the creeping codification of the lex mercatoria and its effect on the concept of good faith. Does this phenomenon hinder the development of the concept?

Undoubtedly, these numerous sets of principles and compilations of the lex mercatoria facilitate the work of the arbitrator. It is considered here that they neither limit the development of the concept of good faith nor encumber that currently applied in international trade, for two reasons.

First of all, the concept of good faith normally embraced in this ambit is cooperation, which could mean a different behaviour according to the case. Therefore, the arbitrator retains autonomy to define the conduct required. In this regard, it must be remembered that arbitral tribunals have been called ‘Social engineers’, as they play a pivotal role in the evolution of transnational commercial law.131

Secondly, these compilations are continuously revised as they attempt to reflect the customs and practices effectively applied in international trade. This means that any change of direction in the understanding of good faith in the lex mercatoria should be rapidly enshrined in these instruments.132

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The relevant part of this article is paragraph a) emphasized, which reads as follows: ‘The Tribunal must decide the dispute according to the stipulations of the contract; it will take into account commercial uses and customs and in the arbitration according to law, it will apply the juridical rules chosen by the parties’. 


For example, the Preparatory work on the UNIDROIT Principles 2004 UNIDROIT 1998 Study L – Doc. 55 declared: ‘The Secretariat will in the meantime continue monitoring the application of the present edition of the UNIDROIT Principles, with special attention to the case law’.

CHAPTER FIVE – THE STANCE OF ARBITRATORS

5.1 PREMISE

The lex mercatoria can be applied by arbitrators on the basis of a specific call in the contract and, when the parties have not specified the applicable law, on the basis of specific rules that provide such applicability. However, the way in which good faith is applied by arbitrators has not been well developed, indicating the need for a strong focus on arbitral awards. Since this approach allows drawing further conclusions on the understanding of good faith in the lex mercatoria supported by empirical evidence, an extensive range of arbitral decisions is at the heart of this thesis.

To obtain arbitral awards this study has benefited from: Unilex, which is a database of international case law and bibliography on the United Nations Convention on Contracts for the International Sale of Goods (CISG) and on the UNIDROIT Principles of International Commercial Contracts – two of the most important international instruments for the regulation of international commercial transactions; TransLex-Principles, which is an online codification and research platform for transnational law; and from other ‘classical' sources of arbitral awards such as the Journal du Droit International (Clunet) and the Collection of ICC Arbitral Awards. For the purpose of this thesis, these have been accessed in the Max Planck Institute for Comparative and International Private Law in Hamburg. Despite this method, the limitation derived from the confidentiality of arbitration must be pointed out, as well as the difficulty of accessing unpublished decisions. However, the awards

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1 The most notable of international arbitral rules sanctioning the lex mercatoria are the ICC Rules where article 17 (1) provides: ‘The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate’.
2 http://www.trans-lex.org/
3 Even in the Preparatory work on the UNIDROIT Principles 2004 UNIDROIT 1998 Study L – Doc. 55 it has been stated: ‘With respect to the case law it is however very difficult to obtain access to the awards rendered world-wide which in one way or another apply the UNIDROIT Principles. Informal contacts have been established with a view to receiving information from the most important arbitration centres concerning the relevant arbitral awards. Results however are still far from being satisfactory. Most of the decisions of which the Secretariat is
available were collected until saturation point was reached in terms of findings, *i.e.*, until no new information – in terms of general trends related to good faith – was discovered.\(^4\)

The main focus is on international commercial arbitration between private parties. However, on a few occasions the awards analysed are related to foreign investment disputes, as they may lead – and often do lead – to the application, at least in part, of the lex mercatoria.\(^5\)

### 5.2 THE INTERPRETATION OF GOOD FAITH

The concept of good faith in the lex mercatoria is understood by arbitrators as cooperation between parties. It implies two aspects:

- A positive aspect, *i.e.*, good faith, corresponding to the expectations of the parties,\(^6\) requires them to behave in order to achieve the aim of the contract;\(^7\)

- A negative aspect, consisting of respect for the other party’s interests.\(^8\) It implies not obstructing or preventing the other party from...
performing the contract and, on the other hand, not to compromise the proper performance of the contract. In modern arbitral practice this aspect of good faith is often cited. For instance in the ICC award n. 5073 rendered in a case between a US exporter and an Argentinian distributor it was stated:

The arbitral tribunal has already stated that California law recognizes an implied covenant of good faith and fair dealing which requires that neither party do anything to injure the right of the other to receive the benefits of the agreement.

The cooperative meaning given to good faith by arbitrators is considered as a consequence of the influence of national laws, the needs of trade and the current cooperative view that permeates contract law today. The Vienna Convention embodies this collaborative view. As stated in article 7 (2) CISG, the mandate is to look first at the interpretation of the provision within the Convention, and secondly (if a gap exists) ‘the general principles on which it is based’. The last resort is national law, identified by the norms of international private law.

What are the ‘general principles’ referred to in CISG?

Reiley identifies the following:
- Uniformity;
- Good faith;
- Full compensation;
- Equality between buyer and seller;
- Respect for different backgrounds;
- Contractual commitment;
- Forthright communication and;

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9 In the sphere of not compromising the performance of the contract there is the legal institution of fraud in civil law systems. At the basis of the contract there is the financial liability of debtors, who respond with their assets. If debtors act, aiming to make their goods harder to seize, compromising in that way the performance of the obligation (fraudulent conveyance), the consequences of that behaviour can be redressed through the actio pauliana. The basis of this action – which pursues the revocation of the act and the reintegration of the assets to debtors – is good faith. See L Carvajal, ‘El Fraude a los Acreedores. La Revocación’ (LLM thesis, Università di Roma Tor Vergata 2006).

10 (1988) 13 Yb Comm Arb’n 68.
- Forgiveness of human error

All these principles reflect the recognition of what Zimmermann calls ‘rematerialization of contract law’ or the end of antagonism – to put it in a striking way. Numerous arbitral awards show that good faith enshrines this philosophy.

In the ICC award n. 2291 of 1975 in the contract concerned a clause provided for an increase of the price – which was actually the claim of the plaintiff. The clause was interpreted in different ways by the French and the English parties. Due to different views, the parties could not renegotiate in order to adjust the contract.

The arbitrator upheld the claimant’s position asking for an increase of the price. The decision was based on the lex mercatoria, because – in the absence of a contract in due and good form – the arbitrator decided to apply ‘the general principles of law and equity, which must rule international commercial transactions’. The award expressed three principles of the lex mercatoria:

1. The obligations must remain balanced, that is, generally obtained through the insertion of ‘hardship’ clauses;
2. *Pacta sunt servanda*;
3. The agreements must be interpreted according to good faith.

The arbitrator in this case appositely declared, ‘This obligation of cooperation, which modern doctrine rightly finds in the good faith principle which must govern the performance of any convention, is necessary’.

This new paradigm in the theory of contract – the cooperative view – is essentially embraced in the notion of good faith in transnational law. This determines that the principle is brought into play, not only as instrumental but,
as it appears inseparably linked (or implied) with the lex mercatoria. The link between these two domains is clear in another arbitral case: *Sapphire International Petroleums Ltd. v National Iranian Oil Co (NIOC).*\(^1^8\)

In 1958 the parties entered into a contract to expand the production and exportation of Iranian oil. The parties set up the Iranian Oil Company (IRCAN) to carry out the terms of the contract on behalf on the parties.

Sapphire International, Sapphire’s subsidiary to which the claimant assigned the contract shortly after its conclusion, started work in the concession area and subsequently claimed the reimbursement of its expenses through IRCAN, as agreed in the contract. However, NIOC refused to reimburse the expenses, arguing that Sapphire International had not consulted NIOC before carrying out its operations. As a result, Sapphire International did not start drilling in the concession area as planned, and NIOC subsequently repudiated the contract on the basis that Sapphire International had not fulfilled its drilling obligations.

In September 1960, Sapphire initiated arbitration proceedings pursuant to the contract, claiming breach of contract and requesting compensation for expenses (incurred before and after the conclusion of the contract); loss of profit and the refund of US$350,000 indemnity, provided by Sapphire as a guarantee at the time of the contract conclusion and later cashed by NIOC.

The core of this case, for the purpose of this thesis, stems from article 38 of the Concession Agreement, which reads:

> Under article 38 para.1 of the agreement the parties undertake to carry out the provisions of the contract in accordance with the principles of good faith and good will and to respect the spirit as well as the letter of the agreement.

This clause influenced the outcome of the controversy in the following way: taking into account this clause, the arbitrator decided not to apply national law, particularly not to apply Iranian law, which seemed at first the logical system to solve the dispute. The arbitrator stated that, ‘Such a clause is scarcely compatible with the internal law of a particular country. It much

\(^{18}\) (1967) 35 ILR 136. The award was given in 1963 by an *ad hoc* tribunal.
more often calls for the application of general principles of law, based upon reason and upon the common practice of civilized countries'.

This reasoning meant that the lex mercatoria was applied as a result of the agreement of the parties to perform the contract in good faith. Traditionally, the situation is the other way round, i.e., because the parties agree that the lex mercatoria must govern their contract, the arbitrator applies the principle of good faith.

This impacted decisively on the final outcome: since good faith was contextualized in the lex mercatoria, the arbitrator granted the plaintiff’s claim on the basis of a lack of cooperation on the defendant’s side. The arbitrator found that the defendant deliberately refused to carry out certain of its obligations and that this failure was a breach of the contract. The arbitrator observed that there was a general rule of private law that states that the failure of one party to a synallagmatic contract to perform its obligations releases the other party from its obligations and gives rise to a right to pecuniary compensation in the form of damages. He also ordered compensation for the expenses incurred by the plaintiff only after the conclusion of the contract and the refund of the indemnity.

In a third arbitral case in ICC award n. 5904 of 1989 the arbitrator applied the lex mercatoria on the grounds of the parties’ agreement. However, in doing so legal categories pertaining to national systems, such as French law and the law of the US, were recalled. In this case, the general conditions of the contract insisted on the importance of delay in the dispatch. Nonetheless, it was stated that, ‘it would be inconceivable that the provider assumes a total warranty for this reason. Such an interpretation would render those clauses as ‘léonine’ (unfair)’. The award finally upheld the claimant’s

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19 Ibid 173.
20 This was also the interpretation held by the plaintiff. As evidence, in a letter sent by Sapphire International to the Shah of Iran and dated 9 July 1959 it is stated: ‘During our initial meetings with the National Iranian Oil Company, we took the precaution of repeatedly pointing out that we were a small company and that this was our first venture outside of North America. In return, NIOC assured us that, although a small company, we would receive the same sincere co-operation and professional treatment afforded companies of major size also active within Iran. Because of this undertaking, we entered into the contract and one of its most important conditions is that the terms and provisions thereof be carried out in accordance with the principles of mutual good will and good faith, the whole as set out in Article 38, para.1, of the contract’. Ibid 153.
position – although it defaulted on its obligation to dispatch on time – because: ‘The principle *pacta sunt servanda* is subject to the concept of *abus de droit*, and to a rule that unfair and *unconscionable* contracts and clauses should not be enforced’. The parties should, therefore, cooperate in the stability of the relation and fulfilment of the contract.

Similarly, the ICC award n. 5485 stated (sic):

Whereas the rule *pacta sunt servanda* implies that the contract is the law of the parties, agreed to by them for the regulation of their legal relationship, and generates not only the obligation of each party to a contract to fulfil its promises, but also the obligation to perform them in good faith, to compensate for the damage caused to the other party by their non-fulfilment and to not terminate the contract unilaterally except as provided for in the contract.\(^{22}\)

Good faith cooperation requires the debtor and creditor to work as partners rather than as adversaries.\(^{23}\) This position is effectively embraced in arbitral decisions and also in restatements of principles; *e.g.* in arbitral award rendered by the Arbitration Centre of the Costa Rican Chamber of Commerce, 1\(^{st}\) June 2003, it was stated (sic):

Each party must act in a way that does not damage the other party and that the parties must comply with this obligation of cooperation that modern doctrine derives from the principle of good faith that must govern the execution of every contract. Additionally, it has recently been provided by ICC International Court of Arbitration that according to the UNIDROIT Principles of International Commercial Contracts, the usages of international trade require good faith in the fulfilment of contractual obligations (ICC, Award 9593, 1998).\(^{24}\)

In two more examples the arbitral tribunal required of both parties a cooperative attitude in the termination of the contract:

\(^{23}\) See the reflections on the ‘cooperative antagonist’ in Chapter Two, n 168.
In the *Wintershall v Qatar*\(^{25}\) the concessionaire was deprived of the benefits of its investments because, by the time the gas discovery was made, the contractual period had expired and the government, on the basis of a contractual provision, had elected to terminate the contract.

This is one of the rare instances in which specific performance was ordered. Strictly speaking, under the classical theory, the government was not in breach of any contractual duty, but it merely exercised a contractual option as a result of which the contract came to its natural end. However, opting in this particular way, and at this time, was both inconvenient and disadvantageous to the other party and the contractual project.

The decision of the tribunal recognized the existence of a duty to cooperate in order to allow the concessionaire to obtain its contractual benefits.

Similarly, in the award rendered by an *ad hoc* tribunal on 3 November 1977, the arbitrators, abiding by the lex mercatoria in the exercise of their power as amiable *compositeurs*, enshrined the notion of good faith cooperation in the final judgement.\(^{26}\) Though the mention of good faith in the form of cooperation is not explicit, it may readily be deduced from the position of the arbitrators, which supports the idea that during the exercise of a right due consideration of the rights of the other party must be held. Here follows the facts and the decision:

The case is *Mechema Ltd. (England) v S.A. Mines, Minéraux et Métaux (MMM) (Belgium)*

MMM was the exclusive world distributor for the products of company E. By a contract of 1 November 1966, MMM granted part of this exclusive distributorship, namely for the UK and Ireland, to Mechema.

By a letter of 19 September 1973, MMM terminated the contract with Mechema as of 31 December 1973. Thereupon, on 7 August 1974, Mechema informed MMM that it would resort to arbitration.

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Mechema structured its claim on the basis of a number of the defendant’s actions in terminating the contract that would amount to conduct against good faith. The arbitral tribunal came to the following conclusion:

Indeed, one cannot deny MMM the right to terminate the contract in accordance with the stipulated notice of three months in advance. But to exercise this right in these for Mechema particularly difficult circumstances, which became even more problematic by the termination of the contract, should be considered as a violation of the notion of equity. This entitled Mechema to damages. In fact, an action may be criticized (even when devoid of any intention of causing damage) when there is disparity between the advantage that a certain way of exercising its rights procures to the owner of these rights and the damage which results therefrom for the other party.²⁷

Additionally, in ICC award n. 7722 of 1999²⁸ good faith implied that both parties should cooperate in the stability of the relation and the fulfilment of the contract. Here, the claimant was a French Contractor and the respondent, a Client (Country X).

The parties agreed that the law of country X be applied in this case. However, the arbitral tribunal did not mention any particular norm of that system of law to interpret the contract. Hence, the requirement of good faith was based on the commerciality of the transaction.

The parties disagreed fundamentally on the interpretation of certain clauses, particularly clause 12.8.2, according to which in every instance of delay not caused by the contractor, it was entitled to an extension of time under this clause and could claim compensation as certified by the client to be ‘fair’.

The tribunal declared that the client did not have an ‘unfettered discretion to act capriciously or abusively’, but ‘reasonably and in good faith’. These terms used by the arbitrator are reminiscent of the new approach adopted by the Dutch Civil Code (given substantive reform in 1992) which does not use the term ‘good faith’ anymore, but terms such as ‘reasonableness and fairness’, aiming to indicate the cooperative conduct required from the parties to a contract. In the common law, one is even more

²⁷ Ibid 80.
easily reminded of Section 1-201 of the UCC which defines good faith as: ‘Honesty in fact and the observance of reasonable commercial standards of fair dealing’.

To act in good faith in this case implied an extension of the time as necessary to obtain the aim of the contract. The tribunal stated:

In determining the substantive claims, the arbitral tribunal took account of respondent having generally refused to grant time extensions or when it did, having made it a condition that the claimant would have to abandon its claims for compensation which in the opinion of the arbitral tribunal did not meet the standards of reasonableness and good faith expected between parties in a commercial contract.  

As in the previous case, the next award illustrates how in many cases, though the law applicable is national law, arbitrators do not refer to any particular norm of the domestic system but base their decisions on the commerciality of the transaction, applying good faith in the context of international trade. In an ICSID case, Klöckner Industrie-Anlagen GmbH (Germany) v United Republic of Cameroon, the parties had entered into several contracts in the 1970s according to which Klöckner had to supply and erect a fertilizer plant in Cameroon. SOCAME, a Cameroonian joint venture, was in charge of the operation of the plant, with Klöckner’s commercial and technical management.

The factory was supplied and erected, but after 18 months of unprofitable and technically inadequate operation under Klöckner’s management, the factory was shut down in 1978. Klöckner filed a request for arbitration in April 1981, claiming the outstanding balance of the price for supplying the factory. The arbitrators rendered an award on 21 October 1983, declaring that the Cameroonian debt to Klöckner was entirely discharged on the grounds of Klöckner’s failure to perform the contract.

Klöckner requested annulment of the award on 10 February 1984, on the basis of article 52 (1) of the Washington Convention of 1965. In its decision of 3 May 1985 the ad hoc Committee annulled the arbitral award.

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29 Ibid 15.
The annulment award recognized that the principle of good faith lies at the root of French civil law. Nonetheless, the reference to the principle was considered insufficient to fulfil article 42 (1) of the Washington Convention. The ad hoc Committee reasoned that the tribunal violated article 42 (1) of the Convention and exceeded its powers by not applying Cameroonian law – based on French law – which is the law of the contracting state. The award states that, ‘The arbitral tribunal has relied in reality, not on a principle of French law but, on a sort of declaration, as general as it is imprecise, of principles alleged to be universally recognised’.

The tribunal – whose decision was annulled – held:

At critical stages of the project (Klöckner) hid from its partner information of vital importance. On several occasions it failed to disclose facts which, if they had been known to the Government, could have caused it to put an end to the venture and to cancel the contract before the expenditure of the funds whose payment Klöckner now seeks to obtain by means of an award (parenthesis added).

The tribunal deduced from this that Klöckner was at fault and in a very significant sense bore responsibility for the ‘fact that the funds were spent’ and that, having violated its duty of full disclosure to its partner, it ‘may not insist upon payment of the entire price of the turnkey contract’.

However, when the tribunal turned to the Cameroonian counter-claim for damages – it requested compensation for all losses attributable to its participation in the project, and in the alternative, compensation for SOCAME’s losses – just as Klöckner’s claim was rejected, the tribunal dismissed the counter-claim, for the following reasons:

There is no justification for charging the claimant with the losses incurred by the government in a joint venture where the two parties participated, or should have participated, with open eyes and full understanding of their actions. One could hardly accept that a State, having access to many sources of technical assistance, could be entitled to claim compensation for the fact that it was misled by a private company proposing a particular contract. If this had been the case, the government would also have had a concurrent responsibility, thereby excluding the counter-claim.
The petitioner pointed out the contradiction in the decision in the following terms: ‘Hence, in order to dismiss Klöckner’s claim, the tribunal holds that it “could have deceived” the Cameroonian Government, while in dismissing the Cameroonian Government’s claim, it emphasizes that the latter could not have been deceived’. It is submitted in this thesis that, there is, in fact, a contradiction and also, most importantly, the tribunal had no basis to state that a government cannot be deceived under any circumstance.

In line with the reasoning of the arbitral tribunal in Klöckner (on the substance), cooperation during the performance implies that, in general, every change must be informed to the other party, especially when it entails an alteration in the risks, a difficulty in the fulfilment of the obligation or anything beyond the contractual provisions. In fact, when the economic equilibrium of the contract is modified, each party must be informed immediately in order to define the conduct to be adopted. This is an efficacy condition. The cooperation between the parties is clearly seen in this situation.\(^{31}\) Here, article 79 (4) CISG:

> The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.

In the aforementioned case *Klöckner v Cameroon* the award on the merits (21 October 1983) embraced neither the claim nor the counter-claim of the parties, since both failed each other in respect of their duty of cooperation, which implies that one party should inform the other party properly and that the other should search for the information according to its possibilities.\(^{32}\)

> An important point, perhaps evident at this point of the study, is that cooperation must come from both parties – creditor and debtor. This

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particularity has been highlighted by international arbitrators when applying national law and the lex mercatoria. For example, in ICC award n. 7314 of 1995 the arbitral tribunal made this statement: ‘The contractual cooperation of the parties ended in June of the seventeenth year’ and that meant the end of the contract.33

In another award, that of 26 May 1982 the lack of good faith on the buyer’s side prevented it from obtaining a positive result.34 The claimant was a Romanian buyer and the respondent a GDR seller. According to a contract concluded in 1978, several labelling machines were to be delivered in the third quarter of 1979. The size of the labels had not been agreed upon. The respondent delivered the machines with a delay of about 90 days and explained that this had been caused by the belated concurrence of the buyer specifying his requirements about the machines. The buyer claimed a penalty for belated delivery according to the General Conditions of Delivery of the Council for Mutual Economic Assistance (CMEA). The buyer stated that there was no obligation to specify the size of the labels as the contract did not contain any express mention thereof.

The arbitrators, taking into account the long-standing business relationship between the two companies and ascertaining that it was the practice to put in writing agreement concerning the desired sizes of labels into production, decided that such practice can be understood as the recognition that the buyer’s concurrence was necessary in order to build the machines. The buyer’s delay in specifying its requirements about the machines caused the delay in delivery (article 13 of the CMEA General Conditions of Delivery). Therefore, the buyer’s claim was not upheld.

Finally, the emphasis on mutual cooperation was also highlighted in a case before the Cairo Regional Centre for International Commercial Arbitration.35 In March 1983 Egypt issued a tender for the supply of 5,000/10,000 tons of frozen chicken. Later in April 1983 it issued another

tender. Both of them were awarded to a French seller. The contracts were concluded according to the Egyptian General Conditions, which, in the main, provides for an inspection of the goods prior to departure and again upon arrival in Egypt.

The French seller made four shipments under the contract but the Egyptian party withheld part of the payment for three shipments and rejected the fourth, alleging that the frozen meat was not in good condition. No inspection was conducted in Egypt.

The seller went to the French courts to obtain payment. After an order from the president of the Paris Commercial Court and two appeals to the Supreme Court, the buyer was required to pay US$1,311,063,27 to the French seller.

The Egyptian party commenced arbitration in Cairo. The French seller filled a counter-claim.

In the decision the arbitral tribunal explicitly declared that contractual obligations must be performed in good faith. The tribunal supported its position with reference to article 184 of the Egyptian Civil Code.

The tribunal emphasized that both parties must implement their contractual obligations in good faith. Consequently, the arbitral tribunal dismissed the claim on the grounds of the failure of the Egyptian claimant to abide by its duty to check the goods upon arrival in the harbour.

5.3 CONCLUSION

It is argued in this thesis – as a deduction from the several arbitral awards analysed – that the role of arbitrators in the development of the lex mercatoria and, specifically, in the determination of good faith’s meaning is enormous. Furthermore, the intervention of these experts allows the meeting of two spheres: national laws and the lex mercatoria. This causes legal effect to be given to new commercial usages and yet maintains a due regard for legal principles. This is the reason for the success of the lex mercatoria.

It is also stated here that the creeping codification of the lex mercatoria does not threaten the essential role of the arbitrator in the shaping of good
faith in a creative manner, because the cooperation-meaning attributed to good faith in the lex mercatoria and then embraced by these instruments is precise but sufficiently ample, allowing experts to adapt good faith according to the needs of the particular case. For example, in one case it will mean that each party assumes a portion of the risk and, consequently, each shares the loss in some proportion depending on the circumstances of the hardship or *force majeure*; in another case good faith means that the buyer should quickly settle a new agreement with another provider if the circumstances are favourable to do so in order to avoid the extent of the losses. The general trend in all of these cases is the accent on cooperation between the parties as the way to interpret good faith.

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36 *Force majeure* or the impediment to perform is enshrined in article 79 paragraph 1 of CISG: ‘A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences’. It is also embraced in article 7.1.7 (*Force Majeure*) of the UNIDROIT Principles.
CHAPTER SIX – CONCLUSION

This final chapter addresses the answers to all six research questions that were presented in the introduction.

QUESTION 1: Is there a system of law called lex mercatoria?

Until relatively recently scholarship distinguished only two sorts of variations in the way to regulate international commerce: international private law (conflict of laws) and international uniform law (i.e., conventions made by national states directly applicable to private legal affairs affected by more than one jurisdiction, for example CISG).

This notion changed in the sixties, if not at general level – full consensus on this issue has never been reached – then in competent circles, at least, the possibility of a third legal order to regulate international transactions started to be discussed. This thesis was built upon this premise, i.e., the emergence of a new way of regulating international contracts. The research conducted revealed that the twentieth century was, in fact, an age of change, where the narrow and inflexible formulae of national laws and international uniform law were overtaken by ‘A set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular system of law’.¹

The lex mercatoria is consolidating its influence in international trade. In practice, the business community is embracing it in international transactions and it is applied in commercial arbitration. Besides, national tribunals have recognized awards based on the lex mercatoria and some national procedural codes consider its application by arbitrators.

QUESTION 2: Does the lex mercatoria exist as an absolute separate phenomenon from national laws?

It is usually accepted that the lex mercatoria requires national laws to regulate certain aspects not considered by that system, such as the validity of the contract and the capacity of the parties.

However, specifically as regards good faith this thesis offered the view that domestic laws are the cradle of the current interpretation of good faith in the lex mercatoria. Therefore, an investigation was conducted into the meaning given by them to this general principle. As a result, the common feature of these national legislations with regard to good faith can be summarized with the word evolution.

France and Germany evolved the concept of good faith as enshrined in their Codes. France, indeed, has evolved from a restrictive notion of good faith to an idea where the obligation is under the influence of the theory of solidarism, which seeks to readjust relations that are not equal, requiring the parties’ full collaboration in good faith. In Germany good faith has had a major development on the basis of section 242 of the BGB, most notably in the area of adaptation of the contract – when supervening and unexpected circumstances occur – and on ancillary duties.

England has evolved its position from a rejection of good faith as a general principle to its incorporation in the statutory law, mainly due to the influence of EU law. Furthermore, evidence has been found in the sense that courts already recognize what the principle is meant to accomplish in commercial contracts. On the other hand, the US has taken a great step to incorporate the general principle of good faith in the UCC. The definition given in section 1-201 of the UCC includes a subjective and objective approach: ‘Honesty in fact and the observance of reasonable commercial standards of fair dealing’. Scholars from this jurisdiction generally explain the meaning of good faith in the UCC and the Restatement (Second) of Contracts (which enshrines good faith in §205) as an objective criterion of reasonable behaviour in order to achieve the aim of the contract.

Some simple examples serve to verify how national laws have influenced the notion of good faith in the lex mercatoria: the change of
circumstances or *rebus sic stantibus* embraced in the lex mercatoria – which brings about the need to readjust the contract.\(^2\) This is a notion developed in Germany in the aftermath of the First World War.\(^3\) Likewise, ancillary duties derived from good faith – *e.g.* duties of confidentiality and mitigation of harm\(^4\) – are currently embraced in the lex mercatoria, as they were originally derived from §242 BGB.\(^5\)

Another example is the omission of the legal concept of consideration in international instruments, as the same option was previously undertaken in the UCC. It must be remembered that today many of the contracts in which good faith performance is of central importance once would have been unenforceable for indefiniteness or lack of mutuality.\(^6\)

National laws are not only the cradle of the current interpretation of good faith in the lex mercatoria but, they have also been influenced by this concept. To put it briefly, for legal experts domestic laws and the lex mercatoria are heterogeneous. The absolute separation of these – national laws and the lex mercatoria – means that their formation must be regarded as having occurred in two completely different phases. However, it has been shown in this thesis that between them there is a perfectly well-defined movement of creative transformation in the area of good faith. There is a mutually reinforcing influence between the lex mercatoria and national laws carried out by arbitrators, by restatements of principles and by uniform and harmonized laws – which enshrine the lex mercatoria to some degree but are applied in national contexts\(^7\) (Fig.1).

\(^2\) Some examples of the embracement of *rebus sic stantibus* in the lex mercatoria: the Force Majeure and Hardship Clauses issued by the ICC in 2003; article 6.2.2 (Definition of Hardship) of the UNIDROIT Principles; and article 6.111 (Change of Circumstances) of PECL.

\(^3\) See Chapter Two, n 133 and accompanying text.

\(^4\) See articles 2:302 (Breach of Confidentiality) of PECL and 7.4.8 (Mitigation of Harm) of UNIDROIT Principles.

\(^5\) See Chapter Two, n 130 and 131 and accompanying text.


\(^7\) Movements of harmonization of law in different regions containing elements of the lex mercatoria are increasing. For example, a group of scholars for the harmonization of Latin American private law was due to meet the 23\(^{rd}\) and 24\(^{th}\) July 2011 in Peru. This is the group’s fourth working meeting; a more recent one was held in Rome in 2010. Statement by Sandro Schipani (Personal communication 7 January 2011). Schipani is the Editor of the Law Journal ‘Roma e America. Diritto Romano e Comune’; and Director of the Centre for Latin American Studies in Rome.
QUESTION 3: What is the meaning of good faith in the lex mercatoria?

The meaning given to the principle in all these spheres (national laws and the lex mercatoria) is cooperation between the parties to a commercial contract.

This answer (which is wider than the question) means that a vast global event is taking place, at this very moment, in international trade. What it amounts to is the meeting of the national laws with the lex mercatoria regarding the general principle of good faith.

The meaning of cooperation given to good faith in national laws and in the lex mercatoria reflects a cooperative trend in the theory of contracts today.

The *laissez faire* and individualism of the nineteenth century changed during the twentieth century. A ‘curvature of the mind’ occurred in the world consisting in an increasing role of government in what were previously private affairs of citizens. Also England (even earlier than in other nations) experienced this move. This trend – which has been called in the body of this

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9 Nonetheless, during the eighties there was an attempt to return to political and economic freedom and liberty of contract, not only in England but over the Western world. According to Atiyah (who fixes the beginning of this new movement of the pendulum with the election of Mrs Thatcher’s Government in May 1979), ‘We find the same faith in Adam Smith and the operation of market forces, the same distrust of government bureaucracies, the same belief in the rights of individual choice’. P S Atiyah, *Freedom of Contract and the New Right* (Juridiska Fakulteten i Stockholm 1988) 6.
thesis ‘compulsory cooperation’\textsuperscript{10} or cooperation from above – continues today at national level. Moreover, it calls for no great experience in European law to see that this tendency – which tends to emphasize the protection of the weaker party – is particularly vigorous today in EU Regulations and Directives.

However, in international trade something particular is occurring: Carson’s denunciation, in the sense that social planning reduces the area of individual decision,\textsuperscript{11} has no place in the lex mercatoria because of the absence of a central authority and the fact that those governed by the lex mercatoria are providing the rules. Hence, they have voluntarily incorporated good faith in the sense of cooperation between parties to a contract, limiting their absolute liberty in favour of the aim of the agreement and, consequently, of the legitimate expectations of the other party. This is explained by the fact that, due to economic interests and strategic considerations, traders are engaging in long-term contracts, avoiding litigation\textsuperscript{12} and entering into partnership contracts whose aim is to maximize their own capacities with the capacities of the other party. The philosophy underlying these contracts in international trade is cooperation and this is, in consequence, the meaning attributed to good faith nowadays. If the matter is understood in this way, good faith ceases to be a discontinuous element in commercial contracts and becomes the fabric from which cooperation in transnational law is woven, since ‘a contract becomes an essential part of the trading relationship’\textsuperscript{13} and a genuine source of transnational commercial law today.

\textsuperscript{10} See Chapter Three, n 36.
\textsuperscript{11} Carson (n 8) 212.
\textsuperscript{12} In many cases the parties resort to non-judicial dispute settlement procedures. This allows a quicker solution and, at the same time, clears the way for further cooperation of the parties in a project or future dealings. Cf. N Horn and J Norton (eds), Non-Judicial Dispute Settlement in International Financial Transactions (Kluwer Law International, London 2000); see also L Mistelis, ‘ADR in England and Wales: a Successful Case of Public Private Partnership’ (2003) 6 ADR Bulletin 53.
QUESTION 4: Is there a unified understanding of good faith in the lex mercatoria?

Good faith cooperation reflects a major phenomenon in the current contractual arena: globalization of commerce and the standardization of production and technological progress have made the contract a legal instrument of collaboration between parties. The following examples illustrate well this assertion: in contracts like factoring, franchising, engineering, transfer of technology, turnkey contracts, strategic aligned partnerships and long-term agreements – such as oil and gas contracts – the fulcrum is cooperation between the parties. The same is true in construction where ‘facilitation of contract performance by the other party is implicit and seriously important, as is the duty to disclose relevant information’.\(^{14}\)

This has determined that the principle of good faith in commercial contracts is generally understood as cooperation, because this notion is the only one that fits in with the experience of commerce nowadays.

QUESTION 5: Is the current concept of good faith in the sense of cooperation a desirable outcome?

The answer is positive. Cooperation has the practical aim of allowing arbitrators to render an award in accordance with the factual reality of commerce where the contract is developed. This is a practical aim, which is similar to the utilitarian aim that good faith presented in Roman law – where the principle was included in the *bonae fidei iudicia*, allowing the praetor to offer solutions non-existent in the civil law. On the other hand, in the Middle Ages good faith was linked to fidelity towards the word given in order to facilitate commercial relationships based on credit and mainly made by people – instead of as by corporations nowadays. During this period good faith was essential in contracts between traders to the point that it was said: ‘*Bona fides*

Today good faith is also the life-blood of trade, since cooperation is the essence of today’s commerce.

QUESTION 6: Is the concept of ‘good faith cooperation’ likely to change over time?

Considering former concepts of good faith in history, such as the practical concept adopted in the Roman process (which allowed the entrance of juridical creations, non-existent at that time, through the intervention of the praetor), the moral good faith in canon law and faithfulness to the word given in the Middle Ages, it is almost needless to say that good faith is a dynamic concept. From a dynamic point of view the object in motion, good faith, is formed by the propulsion of the needs of commerce in a particular era and time. Therefore, in order to answer the present question the way in which traders are developing their businesses in our day and in the near future must be assessed.

It has been stated in this thesis that the concept of cooperation in today’s commerce frequently surpasses the arena of economic exchange and enters into a field of long-term strategic considerations regarding relationships between traders. Buckley and Casson explain that, ‘When only the immediate consequences of an action are considered, it often seems best to cheat. But when the indirect effects are considered, forbearance may seem more desirable. This means, intuitively, that forbearance appeals most to those agents who take a long-term view of the situation’.

In practice, long term contracts are common in international commerce. Some examples are: supply chain management, technology partnering, research and development (R&D) and joint ventures. These

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15 'Good faith is the first motive and the spirit that gives life to commerce’ by G L M Casaregis, Discursus Legales de Commercio ed de Avariis (Genova 1707) 144.
16 By analogy with what happens in physics where Newton’s second law of motion states that the rate of change of momentum is proportional to the force acting on the particle. (Momentum is the product of the mass of a particle and its velocity, \( p=mv \)).
18 One of the reasons for this is that multinational corporations (MNCs) and their foreign direct investment (FDI) in host countries require coordination of economic activities. See G Morgan, P Hull Kristensen and R Whitley, The Multinational Firm (OUP, Oxford 2001).
collaborative businesses consist of coordinated social systems that encourage longer-term commitments which are based on good faith understood as cooperation.

Good faith cooperation is also present in single transactions, as contracts take place in a globalized and interconnected global village where reputation is important to the point of eliciting cooperation.\(^{19}\)

The reality shows that good faith cooperation is a notion that fits the way to deal in international commerce. Because of this utilitarian aim\(^{20}\) it is unlikely to change in the near future.

From a legal perspective, the following evolution of the contract theory has been stated:\(^{21}\) from contractual individualism (nineteenth century), to a cooperation imposed from above (that is, good faith under the aegis of national laws) to the final current stage of voluntary cooperation, where the traders are voluntarily assuming good faith in the sense of cooperation in their contracts. Since the understanding of good faith as cooperation in our particular time in the history of humankind implies that we are part of a society in evolution, it is extremely difficult to predict a return to contractual individualism in the near future. In addition, society is evolving towards cooperative efforts in all ambits of life. Consider, for example, the enshrinement by the Brazilian Civil Code (2002) of the ‘social function of contract’\(^{22}\) and the Wikipedia’s collaborative culture.\(^{23}\) Following this general trend, it is foreseen that good faith cooperation will continue to be embraced by practitioners in cross-border commerce.

\(^{19}\) Cooperation has been recently studied in the field of economic and psychological research by Dr. Christakis and his colleagues at Harvard. They used what is known as a public-goods game for their experiment. It was stated in this study that in the variant where participants had some choice over whom they interacted with the amount of cooperation stayed stable as the rounds progressed. Furthermore, as defectors were shunned, they change their behaviour. A defector’s likelihood of switching to cooperation increased with the number of players who had broken links with him in the previous round. Unlike straightforward tit-for-tat (see Chapter Four, n 47), social retaliation was having a marked effect. See 'The Evolution of Co-operation. Make or Break?' The Economist (London, 19 November 2011) 92-3.

\(^{20}\) See the answer to research question 5.

\(^{21}\) See Chapter Three, Section 3.2.

\(^{22}\) See Chapter Four, n 124.

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