The concept of good faith in Anglo-American law

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In Anglo-American law, *bona fides* or «good faith» is usually defined negatively, being taken to mean the absence of all fraud or unfairness. Such fraud or unfairness deceives its victim, either by concealing a material fact (*dissimulation*) or by pretending the truth of something false (*simulation*). We could as well speak of *mala fides* and both expressions will be used here. We may ask the simple questions, are those who perform an act-in the-law (the English expression for a juristic act) bound to do so in good faith? Or is the juristic act merely nullified by proof of a party's bad faith? If the latter, there will be one of two consequences, depending on which party makes the claim. Either the party in bad faith will be denied the remedy sought, or the party not in bad faith will be relieved of any obligation towards the other.

When does the question of good or bad faith become relevant? In the typical case of an executory contract, is it when the parties negotiate and promise future performance, or when the time[1] comes for the contract to be performed? In modern civil law systems the legislator has required that obligations be performed in good faith : for example, CCiv. art 1134 al 3 ; BGB §242 (though evidence of bad faith at an earlier stage may well result in the obligation being so flawed that it is incapable of being performed in good faith). In branches of the law other than contract the

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1. Or period of time, in the case of a contract of employment : see *Bell v. Lever Brothers,* below.

question must be answered differently. Let us examine this requirement briefly in the Anglo-American law of property, trusts and unjust enrichment, before looking more closely at contract.

PROPERTY AND TRUSTS

In Anglo-American law, where a juristic act (not merely one creating an obligation) is intended to create or transfer an interest in property, good faith has a distinct meaning. We speak of «a purchaser[2] in good faith». In English law, section 205 of the codifying *Law of Property Act* 1925, the keystone of a comprehensive revision of English land law, defines «purchaser» (typically, of land or of an interest in land) to mean a purchaser in good faith[3] for valuable consideration[4] ; it includes a lessee, a mortgagee, and anyone else who, with unimportant exceptions, acquires an interest in property for valuable consideration.

The expression most frequently occurs in the law of trusts, that creation of equity by which, among other things, the managerial duties of ownership (its *gestion*) are distinguished from the beneficial enjoyment of property or its revenues (*jouissance*). By design, the beneficial interests which the trust creates and ensures are commonly of no concern to the world at large. To give a simple example : the trustees are the legal owners of the trust property, consisting of land and associated assets. This property is distinct from their own property (that is, trust property constitutes a *patrimoine affecté*). It may happen that in the course of managing the trust property, the trustees may decide that it is in the best interests of the beneficiaries to sell some of it. The consequence is

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2. *Purchaser* is a technical term for an acquirer who is not a mere donee nor someone who acquires solely *ex lege*, or as it is expressed in English, «by operation of law», like an heir.

3. However, the *Land Charges Act* 1925, section 13 & 14, does not include «good faith» in its definition of a purchaser, distinguishing instead between a purchaser for money or money's worth and a purchaser who does not furnish such consideration.

4. Its usual meaning is a sum of money (excluding token sums) which the parties regard as equivalent to the value of the interest transferred.It includes marriage : that is, an intended marriage can be valuable consideration which justifies the transfer of property, for example from the parents of an intended spouse to one or both of those spouses.

that a «*bona fide* purchaser of the legal estate [that is, the trust property which has been sold] for value without notice of the trust» acquires a good title, free of the claims of the trust's beneficiaries. Are those beneficiaries still protected? Yes ; because the price the purchaser pays becomes subject to the trust immediately, both while it remains as money and if that money is subsequently converted into other property which the trustees have decided is a better investment that the property just sold. (The similarity with *subrogation réelle* and the notarial *clauses d'emploi et de remploi* in the once common French *régime dotal* will be apparent.) But what if the trustees are unfaithful to their duty? What if the purchaser is aware of the trust and agrees with the trustees on a price which defrauds the beneficiaries? The rules of equity have long protected beneficiaries in such cases. The purchaser is not in good faith ; the property he acquires remains subject to the trust and he himself becomes a trustee for the beneficiaries. It is the same with any subsequent acquirer : the beneficiaries have the right to «follow» the trust property into the hands of anyone, with express or implied notice of the trust, who acquires it. The only purchaser who is free from the claims of the beneficiaries is the *bona fide* purchaser of the trustees' legal interest in the trust property, who gives value for it and who is innocent of any knowledge that it was held on trust[5]. In that case, the beneficiaries are left with a personal remedy against the defaulting trustees, which is of course only as valuable as the extent of the fortunes (patrimoines) of those trustees.

THE LAW OF OBLIGATIONS

Restitution or unjust enrichment. For lack of space, the rôle of good faith in the law of restitution cannot be considered in detail. However, it is clear that the rules for the restitution of benefits unjustly retained by one party, to the disadvantage of another who should enjoy them, obviously demonstrate the requirement of good faith, which alone justifies the retention of such benefits.

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5. The law of trusts is a complex subject, not limitd to simple examples like the one given here.

MISREPRESENTATION

In the English law of contract, silence and other forms of innocent or fraudulent[6] misrepresentation by one party can be the basis of a claim for relief (and not only for nullification) by the other party. In the law of tort (and leaving aside criminal liability), a party's good or bad faith may amount to the tort of fraud or deceit, to give it its technical name.

Good faith in the formation of contract. In Anglo-American common law, the rules which govern the formation of contract are often said to demonstrate fair dealing or «equality in exchange». Looking back to the stage at which the contract is being made, it may later be alleged that bad faith was shown in the failure of one party to disclose facts not known to the other nor discoverable by him. It does not necessarily follow that non-disclosure shows such a lack of good faith that the contract can be set aside. The question is rather, how far need one party inform the other about such facts where (for example) both are willing to conclude a contract?

In contrast with the 19th century's assumptions as to the essential equality of adult or commercial contractual parties, modern law distinguishes between contracts where the parties are assumed to be equal, and those where one party is a customer or client – the vogue word is «consumer» – in which case a heavier burden lies on the supplier to communicate facts known to him but unlikely to be known to the potential consumer about the goods or services to be provided. Some recent developments in English law will be mention at the end of this paper. The problem is not new : everyone will be familiar with the crux posed by two Stoics in Cicero, *De Officiis* 3.50-53[7], (discussed *inter alios* by Pothier, *Contrat de vente* §241 in the section on the duties of a seller). If a small fast ship carrying much-needed corn from Alexandria to Rhodes overtakes many slower, heavily-laden corn ships, can the seller of the first cargo exploit the buyers' shortage by charging a high price, or does he show bad faith in concealing his knowledge

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6. Remedies for the victim of innocent misrepresentation were introduced by statute, the *Misrepresentation Act* 1967, following the Law Reform Committee's Report of 1962.

7. Echoing classical Greek law ; cf. the passage in Lysias, *Against the corn-dealers,* § 22.13-16. See also CJCiv D (Ulp) 19.1.11.15 : it is fraudulent non-disclosure to sell a female slave as a virgin when the seller knows that she has borne a child, *sciens errare eum venditor passus sit.*

that the price will fall when the rest of the fleet arrive? Diogenes sided with the opportunist seller ; Cicero sided with Antipater in castigating the seller as acting in bad faith.

A 19th century example from American law echoes this problem. During war between Britain and the US at the start of the 19th century, the price of American tobacco fell, as the British blockade of New Orleans prevented the usual exports to Europe. Laidlaw & Co., Louisiana tobacco merchants, learned privately that the war had ended in 1812 by the Treaty of Gand. Armed with this knowledge, they bought cheaply and took delivery of 111 hogsheads of tobacco from a tobacco merchant, Organ, before the peace became public knowledge and the price of tobacco in consequence rose steeply. Organ sued to recover the tobacco on the grounds of Laidlaw's failure to disclose their information. The US Supreme Court on appeal upheld judgment for Laidlaw, the buyer :

> «The question (said Chief Justice Marshall) ...is whether the intelligence of extrinsic circumstances, which might influence the price of the commodity, and which was exclusively within the knowledge of the [buyer], ought to have been communicated by him to the [seller]. The court is of opinion that he was not bound to communicate it. It would be difficult to [state the contrary so as to keep it] within proper limits, where the means [of discovering the facts] are equally accessible to both parties».
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> Even so, he went on, there are limits :
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> «But at the same time, each party must take care not to say or do anything tending to impose upon [e.g. to deceive] the other...».
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> (*Laidlaw v. Organ* (1817) 15 US 178).

GOOD FAITH IN THE PERFORMANCE OF AN OBLIGATION

Anglo-American law employs a vocabulary redolent of the concept of good faith : words like fair, honest, equitable (in a wide sense) and conscientious (and the negative noun unconscionability).

You will be familiar with §242 of the German Civil Code (BGB), which provides that «an obligor is bound to perform his obligation in good faith, account being taken of normal commercial usage». This is also the approach of the US Uniform Commercial Code (UCC), §2-203 of which says : «Every

contract...imposes an obligation of good faith in its performance or enforcement» and §2-103(1)(b), applicable to contracts of sale, says «good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade». «Good faith» is defined in §1-201(19) as meaning «honesty in fact in the conduct or transaction concerned». These definitions may not seem to go very far[8], but the wide use of jury-trial in civil claims in the common law states of the USA means that the decision as to whether a party's conduct does or does not meet these tests is left to the jury[9].

Let us look at a group of American cases which illustrate the policy of the UCC[10]. The year is 1973. Cotton growers in the southern states entered into their usual forward contracts with middlemen early in the year. In accordance with normal cotton trade custom, prices were fixed for August delivery of cotton grown on specified parcels of land, but without any warranty of quality or quantity. At the time these deals were made, the cotton futures market was quoting 30¢ per pound, and contract prices, agreed between willing buyers and willing sellers, ranged from 29¢ to 41¢ a pound. The growers agreed prices based on their experience of estimating their profit-margins. But between the dates these contracts were concluded and the August delivery date, a number of unexpected events occured, including exceptionally bad weather, reducing the size of the harvestable crop. By August, the spot price (*comptant*) had risen to 80¢ a pound. Across the cotton-growing states, farmers tried to avoid performance, but without success.

These are the homely terms with which US District Judge Owens addressed a jury in one of these cases, tried in Georgia :

> «Ladies & Gentlemen, this case illustrates as well as any case that will ever be in a court-room that life is a two-way street, that when we make bargains that turn out to be good for us we keep them and then, when we make bargains that turn out to be bad for

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8. For a critical account see J. GORDLEY, «Equality in exchange» in *California LR*, 69 (1981), p. 1587 sq., esp. 1645-55.

9. Civil jury trials in England & Wales have been confined to rare cases since 1933 ; and there is no legislation or model law equivalent to the UCC.

10. I quote these instances with gratitude from the contribution to «Contract Law Today (Anglo-French comparisons)», ed. D HARRIS & D. TALLON, Oxford, 1989, p. 86 sq., by Bernard RUDDEN, Professor of Comparative Law, Brasenose College Oxford.

> us, that we also keep them. The defendants naturally don't want to sell cotton because the price has gone up and if I was one of those defendants, I would feel the same way. I would be as sick as an old hound dog who ate a rotten skunk [*qui a mangé le corps d'une mouffette pourrie*] but unfortunately, well not unfortunately, fortunately, we all abide by contracts and that is the foundation of business[11]».

The cotton growers were held to their contracts not only in 13 common law jurisdictions but also in the civil law state of Louisiana, where art 1901 of the Lousiana Civil Code was invoked to order the growers to deliver as they had promised. It reproduces exactly art 1134, *CCiv.*

English law. Until recently, English law has avoided the use of good or bad faith as a test of the due performance of an executory contract, like a contract of employment. In the House of Lords' decision in *Bell v. Lever Brothers Ltd* [1932] AC 161, the defendants (appellants in the House of Lords) were Bell and Snelling, the Chairman and Vice-Chairman of a trading company in West Africa. They had been offered and had accepted large payments (£ 30,000 and £ 20,000 respectively) when their company was absorbed in a restructuring of the activities of what then became the United Africa Company, a subsidiary of what is now Unilever. It was later discovered by Lever Brothers Ltd, who made the payments, that during their employment the two men had speculated extensively in the cocoa market using company funds, to their own advantage though not, in fact, causing their employer any loss. Lever Brothers Ltd brought an action for fraudulent misrepresentation and breach of contract which included a claim for the return of the £ 50,000, claiming that had they known at the time, they would have been justified in dismissing the defendants without compensation. The defendants admitted their liability to account to Lever Brothers Ltd for the profits of their cocoa dealings, but refused to return the £ 50,000. In a majority decision (3:2) which has, it must be said, received much criticism, the House of Lords examined the argument, whether there was a substantial difference between the agreement to end a valid contract of employment (which generated the compensation of £ 50,000) and an agreement to end such a contract which had been broken by one side and could have been terminated without compensation by the other. Each defendant was a party to two distinct contracts : the original contract of employment, and the contract which

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11. Cited 370 F Supp 1359 (1974) ; previous note p. 87 n.14.

compensated for the premature termination of employment for reasons wholly unconnected with Bell and Snelling's misuse of company funds (which in any case was unknown to their former employers). The second contracts were pay-offs – severance or redundancy contracts, and these even benefitted Lever Brothers Ltd, who no longer had to pay the defendants' large salaries. The court was not willing to re-write the original contract of employment so as to provide for dismissal without compensation if the employees speculated as they had done, nor to combine the two separate contracts into one. The notion of good faith was never mentioned ; but it is interesting to speculate on the outcome had such a requirement been applicable.

Attitudes have changed since that case. A recent English case in the Court of Appeal discussing the rôle of good faith in contracts is : *Interfoto Picture Library v. Stiletto Visual Programme* [1988] 1 All ER 348 :

In this case, there was an oral agreement for the hire of photographic transparencies for an exhibition. The owners (a photo archive library) sent the customer 47 of them by post, with a delivery note stating the conditions of hire, clearly marked as such. The 2nd condition required the return of the transparencies within 14 days and the 3rd condition stated that a fee of £ 5 + VAT was payable for each day a transparency was kept beyond 14 days. In fact the defendant hirer decided not to use the photos. He put the packet aside and forgot about it. He later received a bill for £ 3785.50. Judgment for the plaintiff Library was reversed on appeal on the grounds that such a heavy penalty should have been brought expressly to the hirer's attention. As it was not, the condition never became part of the contract. This is how it was put by Lord Justice Bingham (now Lord Chief Justice) :

> «... In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act *in good faith*. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise ; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as "playing fair", "coming clean" or 'putting one's cards face upwards on the table'. It is in essence a principle of fair and open dealing. In [a civil law] forum it might, I think, be held on the facts of this case that the plaintiffs were under a duty in all fairness to draw the defendants' attention specifically to the high price payable if the transparencies were not returned in time and, when

the 14 days had expired, to point out to the defendants the high price of continued failure to return them».

«English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of *unfairness*. Many examples could be given. Thus *equity* has intervened to strike down unconscionable bargains. *Parliament* has stepped in to regulate the imposition of exemption clauses and the form of certain hire-purchase agreements. The *common law* has also made its contribution, by treating as irrecoverable what purport to be agreed estimates of damages but are in truth a disguised penalty for breach [of contract], and in many other ways».

«The well-known cases on sufficiency of notice are in my view properly to be read in this context»[12].

The express requirement of good faith in consumer contracts in English law. Standard Form Contracts[13] (*contrats d'adhésion*) where one party, particularly a «consumer» as that is now defined, has no real possibility of negotiating the terms with the supplier, have received close attention from the courts, which have not been slow to strike out stipulations which too generously favour the supplier. As well as this judicial attention to the weak position of the non-expert customer, for some years now Parliament has legislated in favour of ordinary consumers of goods and services supplied from commercial sources. A statutory non-governmental body, the Office of Fair Trading, was established by the *Fair Trading Act* 1973. Its Director-General was given enlarged powers to investigate and control unfair competition (*concurrence déloyale*) under the Competition Act 1998 ; but from 1973 he has exercised powerful executive and quasi-judicial powers, in the interests of fairness to consumers[14]. The main statutes are now the *Unfair Contracts Terms Act* 1977 and the *Sale & Supply of Goods Act* 1994[15].

Following the United Kingdom's accession to the European Communities in 1972, British courts, applying EC legislation or the

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12. Italic type and words in [square brackets] have been added.

13. See e.g. I RAMSEY, *Consumer Protection – text & materials*, 1989, c.4.

14. Ref previous note, c.7.

15. This Act also amends the *Sale of Goods Act* 1979, a revision of a rare example of codified English law, the 1893 Act of the same name.

case-law of the ECJ,[16] may now refer expressly to the test of good faith in a number of contractual situations. In the law of Agency (*mandat*), Council Directive 86/653 on self-employed commercial agents states that principal and agent owe each other a duty to act in good faith. More explicitly, Directive 93/13 called for national legislation to improve certain aspects of consumer protection. In the UK this has resulted in the *Unfair Terms in Consumer Contracts* Regulations 1994[17] which came into force on 1 July 1995. With certain exceptions[18] the regulations apply to consumer contracts for the provision of goods or services, that is, to private persons except where the goods or services are intended for use in the course of any business conducted by the consumer.

However, the Directives and these regulations make it clear that good faith is not merely required when the contract is *performed*. By Regulation 4(3), in assessing good faith in a particular case, the court must pay attention to four things :

> (a) the strength of the parties' relative bargaining powers ; and
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> (b) whether the consumer was induced to agree to a term, the good faith of which he later questions ;
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> and, for the benefit of the seller or supplier :
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> (c) whether the consumer specified the goods or services in his order (since that shifts the burden on to the consumer) ; and
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> (d) the extent to which the seller or supplier has dealt fairly and equitably with the consumer.
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> [Wording slightly changed for clarity's sake.]

There is as yet scarcely any case-law illustrating how the English courts will apply the Regulations and handle the concept of good faith which this EC-inspired legislation has introduced. If we accept Lord Bingham's account of the matter in the *Interfoto* case, however, we may think that while the terminology may now include

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16. e.g. in interpreting the amended version of art 17 of the 1968 *Brussels Convention on jurisdiction and the enforcement of civil and commercial judgments*, the ECJ has often applied the principle of good faith, for example that the jurisdiction clause is to be assumed to be incorporated in the parties' contract : see *Segoura v. Bonakdarian*, Case 25/76 ; *The Tilly Russ*, case 71/83 – see Legal Studies, 18 (1998), 121, 137 n. 89.

17. S.I. 1994 No. 3159.

18. Notably employment, rights of succession and family law agreements : Reg. 3 (1).

«good faith», the basic insistence on fairness and openness in contractual relations will not change much.

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