CHAPTER 4: THE CONTENT OF THE UNIDROIT PRINCIPLES

3. The Basic ideas underlying the UNIDROIT Principles

(d) Observance of good faith and fair dealing in international trade

If the basic ideas so far discussed clearly aim at rendering the UNIDROIT Principles receptive to the actual needs and expectations of international trade practice, there are others which, on the contrary, are intended to provide to the largest possible extent fair and equitable conditions in cross-border transactions.\footnote{133}

This is true, first of all, as regards the principle of good faith and fair dealing set out in general terms in Art. 1.7 ("Good faith and fair dealing") and which underlies a number of other provisions contained in the UNIDROIT Principles.\footnote{134}

By stating that "[e]ach party must act in accordance with good faith and fair dealing in international trade", paragraph 1 of Art. 1.7 clearly indicates, first of all, that under the system of the UNIDROIT Principles it is throughout the life of the contract, including the negotiation process, that the parties' behaviour must conform to good faith and fair dealing.\footnote{135} In this respect the UNIDROIT Principles follow an approach familiar to the generality of civil law systems,\footnote{136} but not necessarily to common law systems which, even where admitting good faith and fair dealing as a general principle, confine its operation basically to the performance of contracts.\footnote{137}

Secondly, although no definition is given of what is meant by "good faith", the fact that the term is coupled with "fair dealing" makes it clear that it is to be understood in an objective sense, as synonymous with what in the same UNIDROIT Principles is elsewhere referred to as "reasonable commercial standards of fair dealing",\footnote{138} and not in a subjective sense, as a state of mind or just "acting honestly".\footnote{139}

Finally, the reference to "good faith and fair dealing in international trade" (emphasis added) makes it clear that in the context of the UNIDROIT Principles the two concepts are not to be applied according to the standards originally adopted...
within the different national legal systems. In other words, as pointed out in the Comment, such domestic standards may be taken into account only to the extent that they are shown to be generally accepted among the various legal systems. Moreover, since standards of business practice may vary considerably from one trade sector to another, and even within a given trade sector they may be more or less stringent depending on the socio-economic environment in which the enterprises operate, their size and technical skill, etc., a further implication of the language used is that good faith and fair dealing must be construed in the light of the special conditions of international trade.

Passing on to a closer examination of the numerous specific applications of the principle of good faith and fair dealing contained in the UNIDROIT Principles, a first part relates to the formation of contracts.

This includes rules generally accepted at an international level, such as paragraph 2, lit.(b) of Art. 2.4 (“Revocation of offer”) stating that

“[…] an offer cannot be revoked […] if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer”.

or Art. 2.18 (“Written modification clauses”), according to which

“[a] contract in writing which contains a clause requiring any modification or termination by agreement to be in writing may not be otherwise modified or terminated. However, a party may be precluded by its conduct from asserting such a clause to the extent that the other party has acted in reliance on that conduct”.

Yet there are also rules which, at least for some legal systems, may prove to be rather innovative, such as Art. 2.16 (“Duty of confidentiality”) stating that

“[w]here information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded […]”.

and paragraphs 2 and 3 of Art. 2.15 (“Negotiations in bad faith”) according to which

“[…] a party who negotiates or breaks off negotiations in bad faith is liable for the losses to the other party […] It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.”

This last Provision especially, which by imposing on the parties in general terms a precontractual liability for negotiating in bad faith, aims at reconciling freedom of negotiation with the principle of good faith and fair dealing laid down in Art. 1.7, may even be considered revolutionary in some parts of the world.

Other examples of specific applications of the general principle of good faith and fair dealing are to be found in the chapter on interpretation.

For instance, paragraph 2 of Art. 4.1 (“Intention of the parties”) according to which if in the interpretation of the contract it is not possible to establish the common intention of the parties the contract shall be interpreted

“according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances”,

Page: 82

Page: 83

Page: 84
and Paragraph 2 of Art. 4.2 ("Interpretation of statements and other conduct") which for the similar case where in the interpretation of single statements or other conduct of a party that party's intention cannot be established provides that such statements or other conduct shall be interpreted

"according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances".\(^{147}\)

The most significant example, however, is Art. 4.8 ("Supplying an omitted term") which refers to good faith and fair dealing as one of the criteria to be used whenever it becomes necessary to supply a term on which the parties have failed to agree but which is important for determining their rights and duties.\(^{148}\)

With respect to performance, reference may be made, first of all, to Art. 5.2 ("Implied obligations ") which indicates good faith and fair dealing among the sources of the parties' implied obligations arising out of a given contract,\(^{149}\) and to Art. 5.3 ("Co-

operation between the parties") which lays down the basic duty of each party

"[to] cooperate with the other party when such cooperation may reasonably be expected for the performance of that party's obligations".\(^{150}\)

Other significant examples are to be found in Art. 5.8 ("Contract for an indefinite period"), according to which a contract whose duration is neither determined nor determinable may be ended by either party provided that it gives notice a reasonable time in advance,\(^{151}\) in Arts. 6.1.3 ("Partial performance") and 6.1.5 ("Earlier performance") stating that the obligee may not reject an offer of partial performance or an earlier performance if the obligor proves that the obligee has no legitimate interest in so doing,\(^{152}\) and in the above-mentioned provisions on hardship.

The chapter on non-performance also contains a number of specific applications of the general principle of good faith and fair dealing.

Mention may be made of Art. 7.1.2 ("Interference by the other party") which states that

"[a] party may not rely on the non-performance of the other party to the extent that such non-performance was caused by the first party's act or omission or by another event as to which the first party bears the risk".\(^{153}\)

and of Art. 7.1.7 ("Force majeure") which in Paragraph 1 excludes a party's liability for its non-performance due to an impediment beyond that party's control and that it 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.\(^{154}\) Another significant example may be seen in Art. 7.2.2 ("Performance of non-monetary obligations") which, among the exceptions to the general rule that a party is entitled to require performance by the other party not only of monetary, but also of non-monetary obligations, mentions the case where performance is unreasonable, burdensome or expensive or where

the party entitled to performance may reasonably obtain performance from another source.\(^{155}\) Yet another instance is Art. 7.4.8 ("Mitigation of harm") which lays down the duty of the aggrieved party to take reasonable steps to mitigate the harm caused by the defaulting party's non-performance (paragraph 1), while at the same time granting the aggrieved party the right to recover any expenses reasonably incurred in attempting to reduce the harm (paragraph 2).\(^{156}\)
Finally, there are a number of provisions throughout the UNIDROIT Principles which have in common the "policing" of the contract against unfairness. The most significant of these are to be found in Arts. 1.8 ("Usages"), 2.20 ("Surprising terms"), 3.8 ("Fraud"), 3.9 ("Threat"), 3.10 ("Gross disparity"), 4.6 ("Contra proferentem rule"), 7.1.6 ("Exemption clause") and 7.4.13 ("Agreed sum for non performance"); yet in view of their special importance, these provisions will be discussed in greater detail below.\(^{157}\)

What still remains to be seen is the relationship between the principle of good faith and fair dealing and the other basic idea underlying the UNIDROIT Principles, namely freedom of contract.

Paragraph 2 of Art. 1.7 expressly states that the general duty to act in accordance with good faith and fair dealing as laid down in paragraph 1 of the same article may not be excluded or limited by agreement between the parties. In other words, while the parties are of course free to provide in their contract for even higher standards of behaviour, they may not exclude or limit their general duty to observe good faith and fair dealing.\(^{158}\)

This raises the question of whether all the specific applications of the same principle of good faith and fair dealing are also beyond the parties' power to exclude or limit them.

The only direct indications on this point can be found in Art. 3.19 which expressly declares the provisions on fraud, threat and gross disparity to be of a mandatory character, and in Arts. 7.1.6 and 7.4.13 which, though using less explicit language, equally restrict the parties' freedom of contract with respect to exemption clauses and agreements to pay a fixed sum for non-performance.\(^{159}\)

As to the rest, the answer seems on the whole to be in the negative. Most of the provisions in question are merely "default" rules or a sort of background law intended to apply only in the absence of more specific terms in the contract. As such they provide what may be considered the most appropriate solution in the generality of cases, while the parties remain of course free to stipulate differently in order to accommodate their particular expectations and needs.\(^{160}\)

The only exceptions may be found in Arts. 4.8, 5.2 and 5.3. Indeed, these provisions refer, very much like Art. 1.7, to good faith and fair dealing in general terms, with the consequence that the parties are not in a position to anticipate all their implications and should therefore not be entitled to dispense with them from the outset.

[...]

\(^{133}\)For a similar analysis, see R. HYLAND, op. cit. (supra Ch. 3, n. 11), p. 546, who, recalling Jean Carbonnier's distinction between "the morality of business" which "turns the promise into a categorical imperative[...]\(\text{an iron rule of liability}\)" and "the morality of abnegation" which on the contrary "believes more in love than in exactitude, preaches infinite Patience[...]", points out that "[t]he UNIDROIT Principles also attempt to negotiate between the morality of business and the morality of abnegation, between the strict obligatory promise and the equitable flexibility". According to H. HIROSE, op. cit. (supra, Ch. I, n. 16), "[t]he Principles contain not only classical, legalistic approaches (for example, ascertaining the common intention of the Parties), and market-oriented approaches (for example, a concern for the importance of contractual reliance or foreseeability), but also paternalistic intervention (as realized in a case of 'gross disparity') and cooperation-oriented norms (such as a 'cure' or a 'renegotiation')".

\(^{134}\)For a critical analysis of these provisions, see E.A. FARNSWORTH, Duties of Good Faith and Liability for Bad Faith under the Relevant International Conventions and National Laws, in Tulane Journal of International and Comparative Law (1994) (to be published).

\(^{135}\) Cf. Comment 1 to Art. 1.7.


Cf., e.g. Arts. 3.5 and 3.10.

On the two different meanings of the concept of “good faith” in general, see A.S. HARTKAMP, Judicial Discretion Under the New Civil Code of the Netherlands, in 40 The American Journal of Comparative Law (1992), p. 551 et seq., note 6 at pp. 554-555, who rightly points out that “[i]n contract law, acting in good faith refers to […] a purely objective test: if a party acts in an unreasonable and inequitable way, it will not be a defence to say that he honestly believed his conduct to be reasonable and equitable. In the other sense, good faith refers to […] a state of mind (lack of notice) such as a requirement for the acquisition of movable property where the transferor is not the owner of the thing.” Significantly enough, e.g., both in the German and Dutch legal terminology there exist different terms for the objective and the subjective meaning of “good faith”, namely respectively “Treu und Glauben” and “redelijkheid en billijkheid” for the former, and “Gutgläubigkeit” and “goede trouw” for the latter.

Comment 2 to Art. 1.7.

For a similar approach under CISG, which in Art 7(1) equally refers to ”good faith in international trade”, see M.J. BONELL, in C.M. BIANCA - M.J. BONELL, op. cit. (supra Ch. 3, n. 54), p. 86 et seq.

The Provision corresponds literally to Art. 16(2)(b) CISG.

The Provision corresponds literally to Art. 29(2) CISG.


Other instances of negotiating in bad faith may be seen where one party has deliberately or by negligence misled the other party as to the nature or terms of the proposed contract, either by actually misrepresenting facts, or by not disclosing facts which, given the nature of the parties and/or the contract, should have been disclosed: see Comment 2 to Art. 2.15. As to the amount of damages recoverable under precontractual liability, Art. 2.15(2) deliberately uses the term "losses" (as contrasted to "harm") as used in Art. 7.4.2 dealing with damages for non-performance), so as to make it clear that the aggrieved party may in principle only recover the expenses incurred in the negotiations and be compensated for the lost opportunity to conclude another contract with a third person (so-called reliance or negative interest), but may not recover the profit which would have resulted had the original contract been concluded (so-called expectation or positive interest).

Precontractual liability for negotiating in bad faith ("culpa in contrahendo") as a corollary of the general duty of good faith and fair dealing in the bargaining process is a well known principle in the civil law systems, and the entering into negotiations with no serious intention to contract or the abusive rupture of negotiations are generally viewed as among the most significant, though not exclusive, instances of negotiating in bad faith: see, e.g., with respect to German law (where the doctrine of "culpa in contrahendo" was first developed: see R. von JHERING, Culpa in contrahendo oder Schadensersatz bei nichtigen oder nicht zur Perfektion gelangten Verträgen, in Jahrbücher für die Dogmatik des heutigen römischen und deutschen Privatrechts, 1861, p. 1 et seq.; H. STOLL, Tatbestände und Funktionen der Haftung für Culpa in Contrahendo, in Festschrift für E. von Caemmerer, Tübingen 1978, p. 435 et seq.; V.EMMERICH, in Münchener Kommentar zum Bürgerlichen Gesetzbuch, II, Schuldrecht, Allgemeiner Teil, 3rd ed., München 1994, p. 676 et seq. Regarding Italian law (where precontractual liability is expressly sanctioned in the Civil Code: cf. Art. 1337), R. SACCO - G. DE NOVA, op. cit. (supra n. 100), II, p. 229 et seq.; French law, J. GHESTIN, op. cit. (supra n. 103), p. 293 et seq.; J. SCHMIDT-SZALEWSKI, La période précontractuelle en droit français, in Revue internationale de droit comparé 1990, p. 545 et seq.; Swiss law, D. DREYER, Switzerland, in Formation of Contracts and Precontractual Liability, The Dossiers of the Institute of International Business Law and Practice, ICC, Paris 1990, p. 65 et seq.; Dutch law, M.E. STORME, La bonne foi dans les relations entre particuliers. A.-Dans la formation du contrat. Rapport néerlandais, in La bonne foi, op. cit. (supra n. 135), p. 163 et seq. See also Art.1375 of the Civil Code of Québec, according to which “[t]he parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished.” By contrast, common law systems are traditionally reluctant to restrict the freedom of negotiation and favour an "aleatory" view of negotiations according to which parties are at risk until a contract is actually formed. Yet, the absence of a general obligation of fair dealing does not mean that specific Claims for precontractual liability may not be based on other grounds, such as unjust enrichment, misrepresentation or specific promise: see, with respect to the law in the United States (and for interesting comparativist remarks) E.A. FARNSWORTH, op. cit. (supra n. 108), p. 221 et seq.; A. von MEHREN, op. cit. (supra n. 104), p. 64 et seq.; English law, see P.S. ATIYAH, op. cit. (supra n. 77), p. 108 et seq.; Australian law, see CHESHIRe & FIFOOTS LAW OF CONTRACT, Sixth Australian Edition by J.G. STARKE - N.C. SEDDON -M.P. ELLINGHAUS, op. cit., (supra n. 101), p. 47 (who in this respect openly speak of a “broader trend […] evident in Australia, towards the imposition by courts and the legislature of standards of fair dealing”).

The two provisions are taken almost literally from Art. 8(2) CISG.

Supplying omitted terms in accordance with Art. 4.8 corresponds in substance to what is known, e.g., in the law of the United States as "implication" or "inference" (cf. FARNSWORTH ON CONTRACT, op. cit. (supra n. 102), II, p. 302 et
seq.) or in German law as “ergänzende Vertragsauslegung” (cf. T. MAYER-MALY, op. cit. (supra n. 136), p. 1185 et seq.): its characteristic feature lies in the fact that, as pointed out in the Comment (cf. Comment 3 to Art. 4.8), “[t]he terms supplied must [...] be appropriate to the circumstances of the case” and “[i]n order to determine what is appropriate, regard is first of all to be had to the Intention of the parties [...].” Only if the actual or hypothetical expectations of the parties cannot be established, “[t]he term to be supplied may be determined in accordance with the nature and purpose of the contract, the principles of good faith and fair dealing and reasonableness.”

As a possible model for this provision, see Art. 1135 of the French Civil Code (“Les conventions obligent non seulement à ce 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”) (cf. J. SCHMIDT-SZALEWSKI, op. cit. (supra n. 90), p. 305 et seq.), Art. 1374 of the Italian Civil Code (“Il contratto obbliga le parti non solo a quanto è nel medesimo espresso, ma anche a tune le conseguenze che ne derivano secondo la legge o, in mancanza, secondo gli usi e l'equità”) (cf. R. SACCO - G. DE NOVA, op. cit. (supra n. 100), II, p. 401 et seq.), and Art. 1434 of the Civil Code of Québec (“A contract validly formed binds the parties who have entered into it not only as to what they have expressed in it but also as to what is incident to it according to its nature and in conformity with usage, equity or law”), Art. 5.2 and Art. 4.8. may to a certain extent overlap, at least in those cases where in supplying the omitted terms under Art. 4.8 it is not possible to establish the Intention of the parties, so that it becomes necessary to resort to the objective criteria indicated in that same Provision: yet since these criteria - except the additional reference to courses of dealing and usages in Art. 5.2 - are the same, it will in practice make no difference whether the missing term is determined by applying one or the other provision.

For this particular application of the general principle of good faith and fair dealing at domestic level, see, e.g., with respect to the law in the United States, FARNSWORTH ON CONTRACT, op. cit. (supra n. 102), II, p. 316 et seq.; French law, B. STARCK - H. ROLAND - L. BOYER, op. cit. (supra n. 116), p. 503 et seq.; German law, G. ROTH, op. cit. (supra n. 136), p. 144 et seq.; Italian law, CM. BIANCA, op. cit. (supra n. 90), p. 479 et seq.

According to the Comment to Art. 5.8 the rule is based on the widely recognised principle that contracts may not bind the parties eternally and that the latter may always opt out of contracts stipulated for an indefinite period, provided that they give notice a reasonable time in advance. In practice the problem arises most often in case of exclusive agency and distributorship agreements, and of employment contracts: see, e.g., with respect to the law in the United States, FARNSWORTH ON CONTRACT, op. cit. (supra n. 102), II, p. 316 et seq.; English law, CHESHIRE-FIFOOT-FURMSTON’S LAW OF CONTRACT, op. cit. (supra n. 100), p. 551; French law, B. STARCK - H. ROLAND - L. BOYER, op. cit. (supra n. 116), p. 507 et seq.; Italian law, R. SACCO - G. DE NOVA, op. cit. (supra n. 100), II, p. 691 et seq.; German law, J. ESSLER - E. SCHMUST, Schuldrecht, I, Allgemeiner Teil, 6th ed., Heidelberg 1984, p. 291 et seq.

Important tests in this respect will be whether there is an apparent interest of the obligee in receiving full or a timely performance and whether temporary acceptance of partial performance or acceptance of earlier performance will cause the obligee any significant harm: cf. Comment 3 to Art. 6.1.3 and Comment 2 to Art. 6.1.5. For a precedent at international level, see Art. 52(1)(2) CISG, dealing with early delivery of the goods and delivery of an excess quantity, respectively; although the language of the two provisions seems to suggest that the buyer’s option to refuse to take delivery of the goods delivered too early or in excess is absolutely free, it is according to the prevailing view subject to the principle of good faith as laid down in Art. 7 (cf. J.O. HONNOLD, op. cit. (supra n. 95), p. 403 et seq.; R. HERBER - B. CZERWENKA, op. cit. (supra n. 93), p. 239 et seq. As to the risk of overlapping, within the system of the UNIDROIT Principles, between Arts. 6.1.3 on partial performance and Arts. 6.1.2 on instalments, on the one hand, and Art. 6.1.5 on earlier performance and Art. 6.1.4 on Order of performance, see M. FONTAINE, op. cit. (supra Ch. 3, n. 4), p. 650 et seq.

The Provision corresponds in substance to Art. 80 CISG.

The Provision has been taken almost literally from Art. 79(1) CISG.

The right to require performance is also expressly stated in CISG (cf. arts. 46 and 62), but under the Convention a court is not bound to enter a judgment for specific performance unless it would do so under its own domestic law (Art. 28). According to the UNIDROIT Principles specific performance is not a discretionary remedy, i.e. a court must order performance, unless one of the exceptions laid down in Art. 7.2.2 applies. At first sight this approach, which in substance corresponds to the position generally taken by the civil law systems (for a comparative survey, see G.H. TREITEL, op. cit. (supra n. 127), p. 51 et seq.; P. SCHLECHTRIEM, Rechtsvereinheitlichung in Europa und Schuldrechtsreform in Deutschland, in Zeitschrift für Europäisches Privatrecht 1993, p. 217 et seq. (p. 222 et seq.)), may seem to be in contrast with the common law systems, where specific performance is traditionally considered to be the exceptional remedy to be granted only where the normal remedy of damages affords “inadequate” protection to the aggrieved party: on closer examination, however, this is not the case since there is a growing tendency, at least in the United States and Australia, to order specific performance without first asking whether damages are “adequate” and to refuse the former under certain conditions, including those indicated in Art. 7.2.2 of the UNIDROIT Principles. For further references on this point, see FARNSWORTH ON CONTRACT, op. cit. (supra n. 102), III, p. 168 et seq.; G.H. TREITEL, op. cit. (supra n. 127), p. 64 et seq.

For a precedent at international level, see Art. 77 CISG.

See infra, p. 90 et seq.

The mandatory character of the principle of good faith is generally recognized at national level: see, e.g., UCC §
1-102(3) ("[...] the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable"); with respect to German law, G. ROTH, op. cit. (supra n. 136), p. 107 ("Klar ist nach dem zur Funktion des § 242 Gesagten, daß seine Geltung als solche nicht zur Disposition der Parteien steht, auch wenn sie im einzelnen durch privatautonome Risikoerteilung der richterlichen Interessenbewertung Bindungen vorgeben können"). Art. 6.248(2) of the Dutch Civil Code, according to which "[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 equity", goes even further: on this provision see A.S. HARTKAMP, op. cit. (supra n. 139), p. 555, who points out that the "derogating" function of good faith applies to all rules binding the parties as a result of the contract, including relevant statutory rules which govern the parties' relationship.

159 Comment 3 to Art. 1.7.

160 Thus, nothing should prevent the parties from agreeing that contrary to what is stated in Art. 5.8 each of them may end the contract without advance notice, or that notwithstanding the rule laid down in Arts. 6.1.3(1) and 6.1.5(1) a partial or an earlier performance can be rejected at will. Equally, there is no reason why parties should not be free to exclude even in cases of hardship as defined in Art. 6.2.2 any right to request renegotiations with a view to adapting the contract to the changed circumstances, or to impose on themselves, contrary to the general criteria set out in Art. 7.1.7, responsibility even for impediments beyond their control.

Referring Principles:

IV.8.1 - Principle of pre-contractual liability