UNIVERSITY OF CAPE TOWN
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THE ROLE OF GOOD FAITH IN CONTRACT LAW

GOOD FAITH AND UNFAIR CONTRACTS IN SOUTH AFRICA AND GERMANY - A COMPARATIVE APPROACH

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Role of Good Faith in Contract Law

A. Introduction

Good faith is irritating legal systems all over the world, the more so since the principle continuously finds way into various agreements applicable to both national and international transactions. The logical consequence thereof is – or will be – that legal systems that are so far unfamiliar with the principle are forced to employ it to the dispute in question. This fact applies irrespective of its open recognition or its vehement or modest rejection.

Whereas Germany openly recognises good faith as one of the most important aspects of its contract law in various *modi operandi*, South African law, in contrast, contains no such general principle of good faith, although it does have an implicit or undisclosed principle of that sort.

In this essay, I will examine the exposed standing of good faith in Germany and its impacts on contract law, introduced and applied for reasons of fairness and equity. A special regard will be given to its creative function in the field of doctrinal innovations and the necessity to supplement the law under certain circumstances. Because of space constraints, I will restrict the examination to the present *status quo* and not consider the proposals in terms of the forthcoming law reform that might, at least to some extent, turn upside-down a large part of the law of obligations.

Thereafter, I will briefly outline the historical background of good faith in South Africa before turning to the question why good faith has been encountering such a strong opposition as an overriding concept of its contract law. That these oppositions are not justified will be displayed. No reference in this context will be made, however, to the proposals of the Law Commission[1].

Finally, I will present arguments for the introduction and the open recognition of good faith in the South African contract law as a legal principle from which it and the parties involved might benefit.

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[1] Project 47 of the South African Law Commission: Unreasonable Stipulations in Contracts and the Rectification of Contracts; compare further the Working Paper 54 (1994) of the Commission

B. Good faith under German law

Under German law, good faith has become a legal principle of such pervasive influence that shall render superfluous the entire *Bürgerliches Gesetzbuch* (BGB; the German Civil Code[2])[3]; such a view has been repeatedly ventured by a part of the legal writers. It is accordingly held that the whole system of German private law – and particularly the law on unjustified enrichment – is to be taken as a mere embodiment of good faith and could, in theory, be administered solely on its grounds[4]. Consequently, it is held that the provisions of the BGB, and thus the private law as a whole, could be dispensed with and replaced by a single, overriding concept of good faith that governs any private transaction. Such a view, however, has not been able to gain substantiated support, given the fact that good faith applies to a large abundance of various situations[5]. The certainty of private law and its application would entirely be neglected, or even abandoned, if each case was to be adjudicated by good faith. Therefore, this view is untenable.

I. Law-making in Germany

The German legal system is a codified one. Through codification, the legislator attempts to encompass the law in its entirety over a given subject matter within one document. It aims both at the best possible creation of a gapless legal system and a reasonable allocation of judicial and legislative powers[6]. The *Grundgesetz* (GG / Basic Law, the German equivalent of a constitution) foresees in this context in Art. 20(3) GG the parliamentary prerogative and obliges courts to decide "in accordance with statute and law". The reference to "statute" in this passage implies that courts are strictly bound by the fast and hard norms of the codified texts. Yet, by reference to "law", Art. 20(3) GG confers upon the judiciary the right and the duty to make and to develop law, which, however, is only of a supplementary character in terms of the law-making process.

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2 The BGB entered into force on 1 January 1900 and eventually brought about the unification of the formerly fragmented private law of the German Empire (hereinafter referred to as the Code).

3 Cf. Schlechtriem, "Good Faith in German Law and in International Uniform Laws", Introductory Part http://www.cnr.it/CRDCS/schlechtriem.htm

4 Compare Schlechtriem, *supra* n. 3, Introductory Part

5 Compare Heinrichs in *Palandt, Bürgerliches Gesetzbuch* (54th ed., Verlag C.H. Beck, München 1995), § 242 n. 58 et seq.

6 This position was best expressed by F. Wieacker, *A History of Private Law in Europe* (Clarendon Press, Oxford 1995), at 376. He found that "[T]he BGB is a proper Code, that is, it is intended to regulate the matters within its purview completely and exhaustively, in line with the positivist ideal that the judge should be bound to the enacted and gapless text."

II. Judicial leeway despite codification: general clauses

A codified text can be described as a manifestation of willingness of the lawgiver to "freeze" the then contemporary law at one particular moment in time under particular circumstances[7]. In contrast to a code, however, society does not stand still. Faced with the fast and hard norms of the Code and the parliamentary prerogative, the judiciary is vested with the power to develop law by the BGB itself, namely through the implementation of the so-called general clauses[8]. Such clauses consist of open terms that courts are empowered to flesh out with moral and social values and common standards, regard being paid to what the community's values are[9]. It is these general clauses that introduce into the German law system aspects of common law, characterised through only limited or no statutory intervention and the freedom to develop the law as and how courts see fit. The concept of *Treu und Glauben* is the most important of these general clauses.

III. *Treu und Glauben* and the Code: §§ 242, 157 BGB

Treu und Glauben – the German equivalent of good faith – has found its way into two different provisions of the Code, namely § 242 BGB and § 157 BGB. Since these two provisions expressly refer to good faith, they will be subject matter of the forthcoming examination.

1. § 242 BGB

a) Sphere of application

§ 242 BGB simply states that the debtor is obliged to perform in such a manner, as good faith requires, regard being paid to general practice[10]. Taken literally, the norm only refers to how the debtor has to perform (*Leistungserbringung*), a clearly contractual terminology. In terms of the wording, one is thus inclined to assume that good faith is a

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7 Styles, "Good Faith: A Principled Matter", in A.D.M. Forte (ed.), *Good Faith in Contract and Property* (Hart Publishing, Oxford 1999), at 157 (158)

8 Zweigert/Kötz, *An Introduction to Comparative Law* (3rd ed., Clarendon Press / Oxford 1998), at 153 state that "These general clauses of the BGB have operated as a kind of safety-valve, without which the rigid and precise terms of the BGB might have exploded under the pressure of social change."Such general clauses in the purview of the Code are §§ 138; 157; 242; 826 BGB. They will be partly discussed in greater detail below.

9 Heinrichs in *Palandt, supra* n. 5, § 242 n. 2

10 *"Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern"*

standard that only applies to the debtor in the ambit of contractual relationships. Yet, its exposed standing in the section of the general law of obligations (*allgemeines Schuldrecht*, §§ 241 – 432 BGB) – § 242 BGB is one of the opening provisions thereof – militates against such a restrictive approach: its norms apply to both parties, if not otherwise indicated. Therefore, one must conclude that the good faith standard governs both parties' conduct, thus the debtor's and the creditor's alike.

Yet, judges and scholars deny the possible inference that the employment of good faith is restricted to contractual relationships only. In contrast, it is undisputedly acknowledged that § 242 BGB undertakes *any* (natural or legal) person or body to exercise rights and duties in conformity with good faith, irrespective of the kind of relationship of the concerned parties[11]. This view is based upon the presumption that any right however conferred upon persons or bodies entails immanent social-ethical limits and so impairs its unrestricted execution[12]. Hence, it perpetrates not only the law of contract but also the law system as a whole, including administrative and criminal law, then applicable in analogy. It operates as a flee-floating principle that polices and gives shape to any private and / or administrative act[13].

b) Content and meaning of good faith

Difficulties arise as soon as one tries to flesh out the notion of good faith. Because of the far-reaching effect good faith may have and virtually has on the German law[14], its content and its meaning have to be given shape. Reifner, for instance, criticises that § 242 BGB as a statutory provision "lacks all ingredients lawyers would expect from a law: sanction, precise meaning and defined relation to other statutory provisions in the law"[15].

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11 Heinrichs in *Palandt, supra* n. 5, § 242 n. 1; BGHZ 85, at 48; Ebke/Steinhauer, "The Doctrine of Good Faith in German Contract Law", in Jack Beatson and Daniel Friedmann (eds.), *Good Faith and Fault in Contract* (Clarendon Press, Oxford 1995), at 171(171); Markesinis, *The German Law of Obligations – Vol. I: The Law of Contracts and Restitution: A Comparative Introduction* (1st ed., Clarendon Press / Oxford 1997), at 511

12 Heinrichs in *Palandt, supra* n. 5, § 242 n. 1

13 Heinrichs in *Palandt, supra* n. 5, § 242 n. 16-7; BGHZ 30, 236; Roth in *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (2nd Ed., Vol. 2: Schuldrecht – Allg. Teil (§§ 241-432) (Verlag C.H. Beck / München 1985), § 242 n. 56 et seq.

14 The effect of good faith on German contract law will be scrutinised in the following chapters.

15 Reifner, "Good Faith: Interpretation or Limitation of Contracts? The Power of German Judges in Financial Services Law", in Roger Brownsword, Norma J. Hird and Geraint Howells (eds.), *Good Faith in Contract and Context* (The Book Company, Suffolk 1999), at 269 (276, 289, 307)

The criticism that has repeatedly been brought forward is understandable. Yet, one has to take into account that good faith has been introduced into the Code as a flexible instrument in order to deal with situations not provided for therein. Such gaps might have partly occurred as a consequence of negligent drafting and oversight, but more frequently as a result of factual developments which were not, and could not have been, foreseen at the time of the drafting of the BGB[16]. Clear-cut and sharp provisions are not always able to respond to varying circumstances and yield equitable solutions. The recourse to a more general guideline is thus inevitable and indispensable in a code-based law system.

Not only the critics, but also the supporters of good faith have been aware of the flexible character of the concept. In contrast to the critics, however, the supporters feel the need for such flexible notion. Thus, they endeavoured to define *Treu und Glauben* without impairing its ability to supplement the law (good faith as an operator *supplendi causa*)[17].

Schlechtriem has sorted out three levels of values that shape the concept[18]. The highest and most important set of values originates from the German Basic Law, especially from Art. 2(1) GG. The provision grants and protects a right of personality for every human being, expanding to private dealings and contracts, technically achieved through § 242 BGB. On a second level, values are to be extracted directly from other parts of the legal order, such as the Code or further statutory regimes. The third set of values, in turn, is based upon the – changing – convictions of the community, that is a (judicially imputed) conviction and conduct of a fair, decent and reasonable human being.
According to other authors, *Treu und Glauben* carries connotations of fidelity and trust[19]. "*Treu*" in this context denotes aspects of loyalty, reliability, uprightness, ethically motivated conduct, unreserved performance of an undertaking, and mutual consideration[20].

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16 Schlechtriem, *supra* n. 3, ch. III 2 a
17 Whittaker/Zimmermann, *Good Faith in European Contract Law* (1st ed., University Press, Cambridge 2000), at 24
18 Cf. Schlechtriem, *supra* n. 3, ch, IV
19 Whittaker/Zimmermann, *supra* n. 17, at 18; examples in Schlechtriem, *supra* n. 3, ch. IV
20 Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 3; Roth in *Münchener Kommentar*, *supra* n. 13, § 242 n. 5; Lücke, „Good Faith and Contract. Performance" in P.D. Finn (ed.), *Essays on Contract* (The Law Book Company Limited, Sydney 1987), at 155 (163)

"*Glauben*", in turn, refers to faith in a sense that the promisee can expect the promisor to steadfastly and unwaveringly adhere to what has been arranged, promised and agreed upon[21]. Used in conjunction, the concept of "*Treu und Glauben*" functions as a means to introduce social-ethical and communitarian values into the German law system and undertakes parties to take into consideration each other's interests[22]. Hence, one of the main aspects of good faith in the framework of § 242 BGB is the abolition of purely self-interested dealing in favour of a co-operative approach.

2. § 157 BGB

A further explicit reference to good faith is made in § 157 BGB. The norm foresees that contracts shall be interpreted according to the requirements of good faith, ordinary usage being taken into account[23]. Read and applied in conjunction with § 133 BGB[24], the provisions enable courts to determine the core and thus the content of ambiguous and/or contradictory contract terms on the basis of an objective good faith approach[25]. Good faith in the context of contract interpretation requires that, in legal communications, wills of declaration (*Willenserklärung*) are to be interpreted in a way that a faithful receiver would have given it. Hence, courts are bound to decide for the honest listener instead of the internal will of the sender (doctrine of the receiver's horizon / *Empfängerhorizont*)[26] in order to be able to uphold a contract.

3. Differentiation between § 242 BGB and § 157 BGB

The explicit references to good faith in § 242 BGB and in § 157 BGB and their different fields of application already reveal that the concept may assume distinct roles in German (contract) law. Whereas §§ 157, 133 BGB aim at the objective ascertainment of the legal intention of the contracting parties (*das rechtliche Wollen*), § 242 BGB requires parties to

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21 Heinrichs in *Palandt, supra* n. 5, § 242 n. 3; Roth in *Münchener Kommentar, supra* n. 13, § 242 n. 5; Lücke, *supra* n. 20, at 155 (163)

22 Heinrichs in *Palandt, supra* n. 5, § 242 n. 3; Roth in *Münchener Kommentar, supra* n. 13, § 242 n. 5; Lücke, *supra* n. 20, at 155 (163)

23 "*Verträge sind so auszulegen, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern*"

24 § 133 BGB provides that "[I]n interpretation of a will, one must seek out what was really intended and not adhere to the literal meaning of the words used" (*Bei der Auslegung einer Willenserklärung ist der wirkliche Wille zu erforschen und nicht an dem buchstäblichen Sinne des Ausdrucks zu haften*)

25 Heinrichs in *Palandt, supra* n. 5, § 157 n. 1; BGHZ 47, at 78; RGZ 169, at 125

26 Reifner, supra n. 15, at 269 (274); BGHZ 36, 33; BGHZ NJW 1990, 3206; BGHZ NJW 1992, 1446

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render performance due to social and communitarian standards (*das rechtliche Sollen*). A further decisive difference lies in the legal consequences: the violation of § 242 BGB may, e.g., lead to the termination of the contract or the re-exchange of already tendered performances. § 157 BGB, however, does not provide any legal consequences, but only empowers courts to interpret ambiguous contractual terms according to what the parties objectively intended. If the interpretation leads to the conclusion that there effectively was no *consensus*, but a *dissensus*, then the courts are bound to employ § 154 BGB[27].

IV. *Treu und Glauben* and *Guter Glaube*

The concept of *Treu und Glauben* must be sharply differentiated from the concept of *guter Glaube*, often dubbed subjective good faith[28]. Whereas the objective standard of *Treu und Glauben* refers to external, or community, norms imposed upon contracting parties, *guter Glaube* has to do with knowledge of events or circumstances, or the absence thereof[29]. Under German law, the subjective good faith mainly affects property law[30]. Thus, a party who acquires a piece of property from a non-owner acquires nonetheless ownership when s/he was in subjective good faith in terms of the apparent property rights at the time of the transfer of the goods (§ 932 I BGB)[31]; a subsequent gain of knowledge is irrelevant[32]. This somewhat astonishing consequence results from § 1006 I BGB. The norm lays down the presumption that anyone who possesses a piece of property is to be taken as its owner[33]. Yet, the acquirer is not in *gutem Glauben*, if s/he knows or as a result of gross negligence does not know that the piece of property belongs to a third person and not to the transferor (§ 932 II BGB). So, § 932 BGB replaced the ancient Roman "principle of property transferral"[34] with the German "trust principle"

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27 Pursuant to § 154 BGB, a *dissensus*, would render the transaction null and void. "*Solange nicht die Partein sich über alle Punkte eines Vertrages geeinigt haben, über die nach der Erklärung auch nur einer Partei eine Vereinbarung getroffen werden soll, ist im Zweifel der Vertrag nicht geschlossen.*"

28 Whittaker/Zimmermann, *supra* n. 17, at 30; Reifner, *supra* n. 15, at 269 (272); MacQueen, "Good Faith in the Scots Law of Contract: An Undisclosed Principle?", in A.D.M. Forte (ed.), *Good Faith in Contract and Property* (Hart Publishing, Oxford 1999), at 5 (7-8)

29 Whittaker/Zimmermann, *supra* n. 17, at 30; Reifner, *supra* n. 15, at 269 (272)

30 Whittaker/Zimmermann, *supra* n. 17, at 30; Reifner, *supra* n. 15, at 269 (272); MacQueen, *supra* n. 28, at 5 (7)

31 „Durch eine nach § 929 erfolgte Veräußerung wird der Erwerber auch dann Eigentümer, wenn die Sache nicht dem Veräußerer gehört, es sei denn, daß er zu der Zeit, zu der er nach diesen Vorschriften das Eigentum erwerben würde, nicht in gutem Glauben ist." Compare further Reifner, *supra* n. 15, at 269 (272); Medicus, *Bürgerliches Recht* (17th ed., C. Heymanns Verlag KG, München 1993), n. 462

32 Bassenge in *Palandt*, *supra* n. 5, § 932 n. 14, 16; BGHZ 10, 69; BGHZ 30, 374

33 "*Zugunsten des Besitzers einer beweglichen Sache wird vermutet, daß er Eigentümer der Sache sei*"

34 "*nemo plus ius trasferre potest quam ispo habet*"

(*Vertrauensgrundsatz*)[35]. Hence, a presumption exists under German property law that the way property appeared to its acquirer should prevail over the true owner's property rights (*Erwerb kraft Rechtsscheins*)[36]. Therefrom follows that good faith in its subjective form protects the decent, innocent receiver and promotes the well-functioning of commercial transactions. Since this essay is concerned with good faith in the objective sense, no further examination will follow.

V. *Treu und Glauben* and doctrinal innovations

Undoubtedly the most important field of application of *Treu und Glauben* in the framework of German contract law is that of doctrinal innovation. On its basis, various legal institutions have come to life in order to overcome injustice, which would have occurred had the courts applied the norms of the Code without any reflection. It has been used as a means to continuously refine German contract law by way of constantly adapting, adjusting and changing existing legal rules. The refinement eventually resulted in the expansion of contract law into spheres that were originally reserved for the law of delict. Why such a continuous refinement was not only necessary, but also vital will be revealed in the following chapters. Since most of these legal institutions presuppose a violation of secondary obligations, they will be briefly outlined.

1. Primary and secondary obligations

German law sharply differentiates between primary and secondary obligations. This is so because in each contract one finds a cluster of obligations – some of them are primary, and some of them are secondary ones. Primary obligations are duties of performance that give shape to contractual relationships and are decisive factors in their ascertainment[37].

Secondary obligations, in contrast, supplement the primary ones and specify how the parties have to perform under the contract[38]. These are, *inter alia*, obligations of

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35 The same applies to immovable property pursuant to § 892 BGB

36 Bassenge in *Palandt, supra* n. 5, § 932 n. 16; Reifner, *supra* n. 15, at 269 (272)

37 Heinrichs in *Palandt, supra* n. 5, Einl v § 241 n. 6; Ebke/Steinhauer, „The Doctrine of Good Faith in German Contract Law", in Jack Beatson and Daniel Friedmann (eds.), *Good Faith and Fault in Contract Law* (Clarendon Press, Oxford 1995), at 171 (177)

38 Heinrichs in *Palandt, supra* n. 5, Einl v 241 n. 6; Ebke/Steinhauer, *supra* n. 37, at 171 (177)

information, documentation, co-operation, protection and disclosure[39] for which good faith is the standard[40]. They may be imposed upon the parties *ex contractu* or *ex lege* and vary according to the respective (envisaged or stipulated) contract and the stage of contracting[41].

A violation of secondary duties may under certain circumstances lead to the wrongdoer's liability. Since the Code did not (or not satisfactorily) provide for protection in terms of such violations, the judiciary has been prepared to develop new causes of action in order to grant aggrieved parties further remedies, which emanate from the principle of *Treu und Glauben*. Special reference in this context will be made to the *culpa in contrahendo* (under 2.), to the positive breach of contract (3.), to the contract with protective effects towards 3rd parties (under 4.) and to the collapse of the basis of transaction (under 5.).

2. Culpa in contrahendo

The concept of *culpa in contrahendo* (*cic*; precontractual liability) tends to extent the negligent wrongdoer's liability for the violation of secondary duties to pre-contractual relationships. Its early beginnings can be traced back to § 284 I 5 of the *Allgemeines Preußisches Landrecht* (ALR) of 1794[42], but its elaboration and development is generally ascribed to Rudolph von Jhering[43] and has finally been adopted by the judiciary[44]. Although it has never been codified, it is nowadays recognised as customary law[45].

a) Scope of the cic

The Latin term *culpa in contrahendo* indicates that parties must act culpably in the context of the preparation of a contract. On the simplest level of abstraction, this can take the form of the actual opening of negotiations or the bringing about of a contractual contact[46]. The mere prospect of the conclusion of a future contract – even if it never

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39 For a general overview, see Roth in *Münchener Kommentar*, *supra* n. 13, 242 n. 112 et seq.; Medicus, *supra* n. 31, n. 205 et seq.; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 23 et seq.; Ebke/Steinhauer, *supra* n. 37, at 171 (177-8)

40 Whittaker/Zimmermann, *supra* n. 17, at 24; Schlechtriem, *supra* n. 3, ch. III 3 b)-c)

41 Heinrichs in Palandt, *supra* n. 5, n. 23 et seq.; Medicus, *supra* n. 31, n. 206 et seq.

42 Prussian General Law of the Land

43 von Jhering, "*Culpa in Contrahendo* oder Schadensersatz bei nichtigen oder nicht zur Perfection gelangten Verträgen", *JherJB* 4 (1861), at 1-112

44 See, e.g., RGZ 78, 239 (Linoleum case); BGHZ NJW 1962, 31 (Banana Skin case); BGHZ 66, 51 (Vegetable Leaf case)

45 Emmerich in *Münchener Kommentar*, *supra* n. 13, Vor § 275 n. 32-3; BGHZ 6, 333

46 Markesinis, *supra* n. 11, at 64; Palandt in *Heinrichs*, *supra* n. 5, § 276 n. 66

comes into being – creates a quasi-contractual fiduciary relationship between the parties and establishes *ex lege* the mutual expectation of honesty and fair dealing. Such expectations are based upon precontractual standards of good faith. They include the duty to care for the other party's absolute rights (*Verkerssicherungs- und Obhutspflicht*), the duty to disclose material facts to the other party (*Aufklärungspflicht*) and the duty not to break off negotiations without unsound reason (*Abbruch von Vertragsverhandlungen ohne triftigen Grund*)[47]. These precontractual standards are protected by the legal order; hence, any violation thereof may cause liability for the wrongdoer if good faith so requires[48].

Because these obligations do not exist towards the public in general, but solely towards the bargaining partner, *culpa in contrahendo* is not considered a mere extension of tortious liability. It is neither considered to be based on contract, since these obligations arise irrespective of the conclusion of a contract. Therefore, Markesinis termed the *cic* as a "third lane" between contract and delict[49] because it establishes liability for negligence prior to the coming into being of an envisaged contract.

b) Need for introduction: the flaws of German law of delict

It is yet questionable, why it was necessary to introduce the *culpa in contrahendo* into the German law of obligations as a third lane between law and delict. Markesinis has sorted out three distinct functions of the *cic* of which one is to overcome certain flaws in the German law of delictual liability[50]. These flaws derive from the enumeration principle in § 823 I BGB (under (1)), the exculpatory proof in § 831 BGB (under (2)) and the burden of proof (under (3)).

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47 Heinrichs in *Palandt*, *supra* n. 5, § 276 n. 72 et seq.; Emmerich in *Münchener Kommentar*, *supra* n. 13, Vor § 275 n. 75-6

48 Markesinis, , *supra* n. 11, at 64; Whittaker/Zimmermann, *supra* n. 17, at 27; Emmerich in *Münchener Kommentar*, *supra* n. 13, Vor § 275, n. 54 et seq.; Ebke/Steinhauer, *supra* n. 37, at 171 (172)

49 Markesinis, *supra* n. 11, at 64

50 Markesinis, *supra* n. 11, at 64-5

(1) § 823 I BGB and the enumeration principle

Pursuant to § 823 I BGB[51], German delict law protects the enumerated absolute rights (corporal integrity, freedom, economic assets and further absolute rights) only; pecuniary loss is considered a relative right and thus not protected[52]. The only exception to this non-compensation rule is § 826 BGB: the norm, however, foresees that the aggrieved party is entitled to recovery of pure economic loss when the wrongdoer causes damage in a manner *contra bones mores*[53].

The non-recognition of pecuniary loss as a compensatory harm forced academics and judges to expand the contract law in order to accord the aggrieved party a remedy for monetary compensation; an expansion of the law of delict was impossible due to the clear wording of § 823 I BGB. The expansion of contract law was necessary because of the need to grant recovery for economic loss in certain circumstances despite § 823 I BGB. *Treu und Glauben* provided the necessary tool to achieve this desirable goal[54].

(2) § 831 I 2 BGB and the exculpatory proof

A further shortcoming of the Code in terms of relief for the aggrieved party provides § 831 I 2 BGB. The norm establishes a rule of vicarious liability according to which the employer avoids liability for torts committed by her/his employees whenever s/he proves that s/he conducted their selection, their instruction, their training and their supervision with the necessary diligence and carefulness[55]. The employer is equally exculpated when s/he supplies proper equipment. In practice, the employer is in most cases able to lead the exculpatory proof so that, is essence, § 831 I 2 BGB unjustly protects the person from whose sphere of control the damage virtually originates. This problem occurred, *inter alia*, in the so-called "Linoleum case"[56]. The *Reichsgericht* (the then German Imperial

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51 "*Wer vorsätzlich oder fahrlässig das Leben, den Körper, die Gesundheit, die Freiheit, das Eigentum oder ein sonstiges Recht eines anderen widerrechtlich verletzt, ist dem anderen zum Ersatze des daraus entstehenden Schadens verpflichtet.*"

52 Thomas in *Palandt*, *supra* n. 5, § 823 n. 31; BGHZ 41, 127; Horn/Kötz/Leser, *German Private and Commercial Law: An Introduction* (1st ed., Clarendon Press, Oxford 1982), at 149

53 "*Wer in einer gegen die guten Sitten verstoßenden Weise einem anderen vorsätzlich Schaden zufügt, ist dem anderen zum Ersaze des Schadens verpflichtet.*"

54 Whittaker/Zimmermann, *supra* n. 17, at 27

55 "*... Die Ersatzpflicht tritt nicht ein, wenn der Geschäftsherr bei der bestellten Person und, sofern er Vorrichtungen oder Gerätschaften zu beschaffen oder die die Ausführung der Verrichtung zu leiten hat, bei der Beschaffung oder der Leitung die im Verkehr erforderliche Sorgfalt beobachtet oder wenn der Schaden auch bei Anwendung dieser Sorgfalt entstanden sein würde.*"

56 RGZ 78, 239; cf. Markesinis, *supra* n. 11, at 65

Court) held that it would be contrary to the general feeling of justice – and thus contrary to the precepts of *Treu und Glauben* - if a prospective purchaser gets injured due to the faulty conduct of an employee, whereby the employer succeeds in exonerating himself under § 831 I 2 BGB. The unwanted and inequitable consequence would be that the injured person would have to sue the usually impecunious employee for the rectification of the damage.

This deficiency of the German tort law can again best be rectified through the expansion of contract law into the spheres of tort law. This results in the possible application of the contractual standards of §§ 276, 278 BGB[57]. These norms impose upon the employer an unconditioned liability for the wrongs of third persons s/he is accountable for (*Erfüllunsgehilfe*); the possibility of exoneration pursuant to § 831 I 2 BGB is absent in this case. Again, the precepts of *Treu und Glauben* pursuant to § 242 BGB are employed to overcome injustice arising from the strict norms of German tort law.

(3) Burden of proof

The burden of proof is a further example why the expansion of contract law was necessary in order to yield equity. Whereas in the realm of tort law, the plaintiff has to prove the wrongful act, causation and fault of the wrongdoer, contract law foresees in § 282 BGB[58] that under certain circumstances, the burden "is upon the debtor". Although the norm explicitly refers to cases of impossibility, the *Bundesgerichtshof* was prepared to apply it analogously in the so-called "Vegetable leaf case"[59] to the area of precontractual liability. It held that the burden of proof relates to "areas of organisation and potential and responsibility"[60]. On the grounds of this interpretation, the court concluded that the plaintiff had to prove that the injury occurred due to the carelessness of the defendant only. Fault on the part of the defendant was then presumed, but not irrebuttable. It was thus on the defendant to show that the injury was not caused by her/his faulty conduct.

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57 *"Der Schuldner hat ein Verschulden seines gesetzlichen Vertreters und der Personen, deren er sich zur Erfüllung seiner Verbindlichkeiten bedient, in gleichem Umfange zu vertreten wie eigenes Verschulden."*

58 *"Ist streitig, ob die Unmöglichkeit der Leistung die Folge eines von dem Schuldner zu vertretenden Umstandes ist, so trifft die Beweislast den Schuldner"*

59 BGHZ 66, 51

60 BGHZ NJW 1987, 639 (640)

The intrusion of § 282 BGB into the realm of tort law reveals how courts take into account its flaws and are prepared to "circumvent" these provisions by employing rules of contract law. They are empowered to do so on the grounds of § 242 BGB.

(4) Conclusion in terms of the need for introduction

In conclusion, the extension of contractual liability into the realm of tort law is justified. It serves as an equitable means to protect the legitimate interests and expectations of the aggrieved party which, under certain circumstances, could not be achieved through the strict application of tort law rules.

The reason for justification lies in the fact that the injured person enters into the sphere of control and organisation of another person for the purpose of negotiation. Hence, both bargaining partners can mutually rely on each other's enhanced carefulness. Its disappointment is protected by *Treu und Glauben* when it leads to a recoverable, albeit pecuniary harm[61]. So found the Reichsgericht in the "Linoleum case" that contractual standards of liability have to be applied to situations of precontractual contacts. In these cases, it held, both the seller and the prospective buyer come under the duty to "observe the necessary care for the health and the property of the other party". The law of delict, as alluded to above, cannot provide this kind of protection; the expansion of contract law was thus inevitable.

c) Requirements

A successful claim based upon the *cic* requires (1) a specific relationship between the parties, (2) a harming conduct, and (3) a faulty causation of damage. Absent a codification of the *cic*, these requirements are to be inferred from German case law.

(1) Specific Relationship

Liability occurs in the context of a specific pre-contractual relationship between parties. A special relationship is not any remote connection or a merely intensive social contact, but demand that the parties come together in the context of some legal transaction, which,

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61 BGHZ 66, 51; Markesinis, *The Law of Torts: A Comparative Introduction* (3rd ed., Clarendon Press, Oxford 1997), at 777

however, need not amount to negotiations[62]. When such border is crossed depends on the surrounding circumstances of each case. It is recognised, however, that such special relationship is established when party enters into the other party's sphere of control in order to conduct some sort of business[63]; this includes, but is not limited to, the entering into negotiations.

(2) Harming conduct

The plaintiff must have been harmed through the defendant's conduct, viz through an act or an omission. A conduct is deemed harming when and where the defendant – or any other third person s/he has to assume accountability for – violated one or more of the secondary obligations. The first group of cases in this regard concerns a defendant's harming conduct during the bargaining process, insofar as the lack of ability, willingness, or capacity to contract with the plaintiff is reproachably concealed. The second group deals situations in which the defendant admittedly acts faultless during the pre-contractual phase, but reproachably nourishes the plaintiff's sound expectancy that the contract will come into being and then walks away from the negotiations without sufficient and sound reason (so-called cases of failed negotiations)[64]. A harming conduct may furthermore occur where the defendant fails to take care of the other party's legitimate interests (see the Linoleum case).

(3) Faulty causation of damage

Eventually, the defendant must have culpably brought about damage for the plaintiff through her/his harmful conduct. Yet, as a general rule, compensation for damage is limited to the negative interest[65]. The rationale for liability stems from the lack of need of protection for the wrongdoer. Anyone who fails to reassure her-/himself about hindrances with regard to the conclusion of a contract that lie within her/his sphere of control thereby

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62 RGZ 78, 239

63 Heinrichs in *Palandt, supra* n. 5, § 276 n. 65-6; 72-6; Markesinis, *supra* n. 11, at 64; BGHZ 6, 333

64 BGHZ 71, 395; BGHZ NJW 1975, 1774; Emmerich in *Münchener Kommentar, supra* n. 13, Vor § 275 n. 9

65 Liability limited to a party's negative interest means that the plaintiff has to be put into that position s/he would be in had s/he not relied on the validity of the contract, cf. Heinrichs in *Palandt, supra* n. 5, Vorbem § 276 n. 17

inspiring trust in a way that everything is in order, must not benefit from law to the expense of others.

d) Conclusion

The *cic* is a necessary device to overcome the shortcomings of German tort law. Nonetheless, one has to take into account the dangers that are closely connected with its wide range of applicability and the intrusion into spheres that are originally domains of tort law and freedom of contract. This is even more so since the concept is entirely founded upon a normative basis that, in turn, is shaped by the concept of *Treu und Glauben*. In this context, it is cynically said that the *cic* applies to cases which have nothing in common but the fact that they do not fall under any other statutory basis for liability[66]. Authority on the concept, however, reveals that courts have with some consistency applied the cic with responsibility and carefulness. Therefore, it can be assumed that both courts and scholars assume a "watchdog role" of a sort that abuse of the concept will be condemned immediately. So, however, it is an indispensable tool enabling courts to hand down equitable decisions.

3. Positive breach of contract

Whereas the *cic* applies to violations of secondary obligations during the pre-contractual phase, the positive breach of contract (*positive Vertragsverletzung*, *pVV*)[67] sanctions violations of duties after the contract has come into being. It thus can be described as the legal mirror of the *cic*. Whether or not the doctrinal peg for the development of the *pVV* was § 242 BGB[68] or other rules of the Code[69], is irrelevant. What matters is that the precepts of good faith are relevant for determining the range of secondary duties violation

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66 Emmerich in *Münchener Kommentar*, *supra* n. 13, Vor § 275 n. 32; v.Bar, "Vertragliche Schadensersatzpflichten ohne Vertrag", *JuS* 1982, 637; Gottwald, "Die Haftung für Culpa in Contrahendo", *JuS* 1982, 877

67 The positive breach of contract is nowadays established and recognised as a genuine cause of action, cf. Horn/Kötz/Leser, *supra* n. 52, at 107; Ebke/Steinhauer, *supra* n. 37, at 171 (174); Medicus, *supra* n. 31, n. 306 et seq.

68 Cf. BGHZ 11, 80 (84); Ebke/Steinhauer, *supra* n. 37, at 171 (172)

69 The *Reichsgericht* originally based the doctrine on § 276 BGB, a norm that yet determines the standard of liability and not the situation in which the debtor is to be held liable. Later on, the doctrinal basis was an analogy to §§ 280, 286, 325, 326 BGB before it finally became recognised as customary law.

of which leads to a liability in damages[70]. Today, the positive breach of contract is regarded customary law[71].

a) Special regimes in the Code in terms of malperformance

Generally speaking, a creditor to a contract is entitled to the contractual performance according to the stipulated agreement. Where and when the performance for one reason or another goes partly or entirely wrong, the creditor has the right to invoke the special regimes for relief as expressly provided for in the Code. These are impossibility (*Unmöglichkeit*, §§ 274, 280; 323-5 BGB), delay of the debtor (*mora debitoris / Schuldnerverzug*, §§ 284-92 BGB) and liability for warranties (*Mängelgewährleistungsrecht*, §§ 459-80; 537-40 BGB).

b) Need for introduction: the shortcomings of the law on malperformance

Soon after the Code had come into force, it became obvious that the statutory provisions do not wholly cover the broad area of irregularities of contractual performance. Cases in which the debtor to a contract either performs badly (*Schlechtleistung*), that is incompliant with the contractual obligations, or violates a secondary duty were left unregulated. The Reichsgericht took these gaps into account in the so-called "Fodder case"[72] and implemented the *pVV* a residual category, which was meant to cover all cases of bad performance. In this case, the defendant delivered contaminated fodder, which caused the death of two of the plaintiff's horses. The latter sought compensation for the damage; yet, no statutory relief was available for this kind of malperformance. Both impossibility and delay do not provide for compensation for damages to other property than that delivered (*Mangelfolgeschaden*).

The norms on impossibility do not cover cases of malperformance for a further reason. § 243 BGB foresees that the debtor is obliged to deliver goods of ordinary and average quality only, namely generic goods (*Gattungsschuld*)[73]. Therefrom follows that any

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70 Whittaker/Zimmermann, *supra* n. 17, at 27

71 Heinrichs in *Palandt*, *supra* n. 5, § 276 n. 105; Emmerich in *Münchener Kommenar*, *supra* n. 13, Vor § 275 n. 96; BGHZ 11, 80 (83 et seq.); Medicus, *supra* n. 31, n. 316

72 RGZ, 66, 289

73 "*Wer eine nur der Gattung nach bestimmte Sache schuldet, hat eine Sache von mittlerer Art und Güte zu leisten*"

performance is deemed rendered as soon as some performance is rendered that cannot be qualified as an *aliud*[74]. This results in the fact that the debtor has complied with her/his primary obligation to deliver, albeit badly, which, in turn, excludes the applicability of the regime on impossibility[75]. Since the vendor in the Fodder case neither guaranteed delivery of proper fodder or fraudulently concealed its poisonous effect – which, in turn, would have allowed a claim for such compensation, see § 459 II (*zugesicherte Eigenschaft*), § 463, 2nd sentence (deceit) –, the *Mängelgewährleistungsrecht* pursuant to §§ 459 ff. BGB was inapplicable.

That the plaintiff should burden the damage in that case appeared unjust and contrary to the precepts of *Treu und Glauben*. The need for judicial innovation was thus strikingly apparent which eventually resulted in the introduction of the *pVV* into German contract law. In essence, this meant a considerable of the debtor's liability for malperformance, whereas the creditor was accorded a further remedy, based on good faith[76].

c) Requirements

The requirements for the invocation of the remedy have never been codified, but are to be deduced from the manifold and extensive German case law on this issue[77]. It requires (1) a gap in the Code in terms of malperformance, (2) a contractual relationship, (3) a violation of a secondary duty, and (4) a culpable causation of damage.

(1) Gap / Subsidiarity

The *pVV* is of subsidiary character. This means that the alleged violation of the defendant's obligation must not amount to impossibility or delay or be specifically covered by the provisions of the law on liability for warranties[78].

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74 The distinction between *aliud* and malperformance is by no means easy to draw. Because of the topic of the essay and space constraints, I will not go into detail concerning this distinction, the more so since case on this topic law reveals no stringent methodology of interpretation.

75 Medicus, *supra* n., 31, n. 306; Heinrichs in *Palandt*, *supra* n. 5, § 243 n. 3-4

76 BGHZ 11, 80 (84); Ebke/Steinhauer, *supra* n. 37, at 171 (172 et seq.)

77 Cf. Markesinis, *supra* n. 11, at 423-4; Medicus, *supra* 31, n. 306 et seq.;

78 Yet, its subsidiarity does not impair the raising of delictual claims if the wrongdoer's conduct was also tortious: such a claim is deemed independent from the quasi-contractual claim, compare Ebke/Steinhauer, *supra* n. 37, at 171 (175); Horn/Kötz/Leser, *supra* n. 52, at 107; Medicus, *supra* n. 31, n. 309; Heinrichs in *Palandt*, *supra* n. 5, § 276 n. 109; BGH NJW 1983, 1188

(2) Contractual relationship

Furthermore, a contractual relationship that forms the basis of their respective duties must exist between the parties.

(3) Violation of a secondary duty

Then, the defendant must have breached one or more of the obligations imposed upon her/him. Although the heading speaks of a "positive" breach, that is a positive action, it is acknowledged that the defendant's conduct may equally consist of an omission[79]. A breach of obligations may occur in two different ways: the defendant has either breached a primary duty (for instance, delivery of false quantity) or a secondary duty, which tend to accompany the duty to perform the main obligation under the contract[80]. The breach of a secondary duty is regarded, as one can infer from above, as a violation of the good faith standard that is legally protected, and be it through judge-made law.

(4) Culpable causation of damage

The wrongdoer must have culpably (*schuldhaft*) breached . Culpability presupposes either negligent or intentional conduct on the part of the defendant or the persons s/he has to assume accountability for[81]. Eventually, the defendant's breach must have causally led to material damage for the plaintiff.

d) Conclusion in terms of the *pVV*

Once again, it was a flaw of the German tort law that made necessary the development of a new cause of action, namely the *pVV*, in order to be able to cover all cases of malperformance. Since the *Reichsgericht* had to apply the provisions of the Code strictly (principle of parliamentary prerogative) and a judicial law-making *contra legem* was (and is) prohibited, it employed *Treu und Glauben* in order to avail to the plaintiff a further, equitable remedy.

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79 Markesinis, *supra* n 11, at 423

80 Markesinis, *supra* n. 11, at 423; Heinrichs in *Palandt*, *supra* n. 5, § 276 n. 113

81 Markesinis, *supra* n. 11, at 423; The *Bundesgerichtshof*, however, relinquishes the requirement of accountability. The Court rather employs §§ 282, 285 BGB in analogy and holds the defendant liable where and when the plaintiff can show that the cause of the harm comes from the defendant's sphere of control. It thus sanctions the personal reproachability (*persönliche Vorwerfbarkeit*).

4. Contracts with protective effects towards 3rd parties

German courts have further broadened the class of potential 3rd party claims through the implementation of the "contract with protective effects towards 3rd parties" (*Vertrag mit Schutzwirkung für Dritte; VSD*), a legal construct that has found its justification on the good faith principle[82]. The judicial variant of the contract in favour of 3rd parties (*Vertrag zugunsten Dritter*, § 328 BGB) brings individuals, not being formally in privity of contract and not being a 3rd party beneficiary, under the protective umbrella of a contract formed between others and allows them to entertain an action for damages for breach of one of the contract's secondary obligations[83].

a) Authority on contracts with protective effects towards 3rd parties

It was with the so-called "Water heater case"[84] that the Reichsgericht leaped forward and extended the debtor's obligations of care towards third parties. In this case, a tenant contracted with a repair firm for the repair of a gas-operated water heater, which was in the dwelling. Due to fault on the part of the gas fitter, the heater exploded and caused injuries to a cleaning lady employed by the tenant. The *Reichsgericht* held that, under the doctrine of good faith, a secondary obligation to take care arose from the contract between the tenant and the repair firm, which was owed not only to the tenant but also to the tenant's cleaning lady; pecuniary relief was accordingly granted[85]. The sphere of application was yet restricted to cases involving physical damage.

In the forthcoming, the *Bundesgerichtshof* was prepared to go a step further in the "Testament case"[86]. It gave up the restrictive application of such contracts and extended the wrongdoer's liability to cases involving pure economic loss, again a considerable expansion of liability on the grounds of § 242 BGB to situations that were left unregulated in the Code.

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82 Heinrichs in *Palandt, supra* n. 5, § 328 n. 14; Medicus, *supra* n. 31, n. 844-6; Markesinis, *supra* n. 11, at 513

83 Ebke/Steinhauer, *supra* n. 37, at 171 (176); Markesinis, *supra* n. 61, at 50; Heinrichs in *Palandt, supra* n. 5, § 328 n. 13

84 RGZ 127, 218

85 The dilemma of the German statutory regime was revealed in this case: the lady could also have brought a tort action against the repair firm under the principle of *respondeat superior*, or vicarious liability pursuant to § 831 BGB. Under German tort law, however, employers are not liable for acts and omissions of their employees, if the employer can prove that s/he was not personally at fault. To satisfy the requirement of exculpatory proof, the defendant must simply establish that s/he took all requisite precautions in selecting, training, instructing and supervising the employee. Under German contract law, in turn, a party to a contract was only personally liable to the other party to the contract, but not to 3rd parties.

86 BGHZ NJW 1965, 1955; BGHZ JZ 1966, 141

b) Need for introduction

The situations concerning the sphere of application of the *VSD* have all in common that the 3rd party is virtually a non-party to a contract, thus without any contractual protection had the court not recognised this legal institution. The establishment of the *VSD* enabled courts to grant compensation for suffered physical injuries and for incurred economic loss for the benefit of 3rd parties.

(1) Physical injuries

In cases of physical injuries, 3rd parties had to rely on remedies for compensation provided by tort law, and here in particular on § 831 I 2 BGB, in the absence of a contract. As already alluded to above, the norm establishes a weak rule of vicarious liability for the master with the possibility of the exculpatory proof for the wrongs of her/his servants. This means in essence that 3rd party claims for compensation failed as soon as the master could successfully prove that he acted with the reasonable care. Matter-of-factly, non-compensation turned out to be the rule rather than the exception, a situation that required immediate rectification.

The *Reichsgericht* took this shortcoming into account in the "Water heater case". It acknowledged that the secondary obligations (of care) are not only owed to the creditor to the contract, but to 3rd parties as well. Otherwise, the wrongdoer's contractual liability would have depended upon mere random: liability if the contractant happened to suffer physical injury, and non-liability if the non-contractant happened to suffer physical injury, also if both were exposed to the same dangers. Yet, the distinction appeared arbitrary and unjust. Thus, the *Reichsgericht* established a contract-based liability in a way that made the wrongdoer accountable towards 3rd parties for any breach of her/his secondary obligations leading to physical damage. The reasoning enabled the *Reichsgericht* to overcome the narrow § 831 I 2 BGB and to grant the injured party the appropriate quasi-contractual protection.

(2) Recovery of pure economic loss

In 1965, the *Bundesgerichtshof* gave up the limited applicability of the *VSD* in the "Testament case" and expanded it to cases involving pure economic loss, deemed irrecoverable under § 823 I BGB (see above). Yet, there were cases – such as the "Testament case" – in which recovery of pure economic loss was considered justified. This fact, coupled with the (imputed) promisor's knowledge in terms of the involvement of a third party and the restriction to a considerable group of possible beneficiaries, prompted the *Bundesgerichtshof* to extent liability to cases involving pecuniary damage[87]. Because of the strict wording of § 823 I BGB, the court was compelled to extent the application of the *VSD* to said cases where the promisor breached a secondary obligation. Stripped to its essentials, however, one must contemplate that a claim based upon the *VSD* is virtually a tort claim, which is merely dressed up in contract clothes[88]. In other words: the *VSD* appeared as an appropriate and equitable tool to avoid non-recovery of monetary harm. Good faith, thus, helped to overcome one of the basic tort law rules and allowed the court to grant compensation.

c) Requirements

The inclusion of 3rd parties into contracts apparently means an extension of liability for the promisor. The question that inevitably arises in this context is where the promisor's liability ends (the "flood gates argument"), particularly once the recovery for economic loss was judicially recognised. Although § 242 BGB allowed the development and the extension of the *VSD*, it equally limits the wrongdoer's liability towards 3rd parties, which can be inferred from the requirements for its application. These (mainly normative) requirements are (1) the proximity of performance, (2) a protective interest and (3) the foreseeability.

87 Cf. Markesinis, Vol. I, *supra* n. 11, at 279

(1) Proximity of performance

Firstly, there must be an especially close relationship between the 3rd party and the promisee, usually referred to as proximity of performance (*Leistungsnähe*)[89]. This means that the 3rd party is generally, not accidentally, exposed to the same dangers and hazards during the performance of the contract like the promisee[90].

(2) Protective interest

Secondly, the promisee must have a legitimate interest in the protection of the 3rd party (*Schutzinteresse*). The judiciary approaches the question in terms of the protective interest in two different ways. In cases of physical damage suffered by the 3rd party, courts require that the promisee is "responsible for the better and the worse" (*Wohl und Wehe*)[91]. This is so when there is some personal relationship (*personenrechtlicher Einschlag*) which, e.g. exists in family-, labour- and rent-related matters[92]. Where the 3rd party suffers economic loss, however, the *Bundesgerichtshof* relinquishes the "*Wohl und Wehe*" requirement and asks whether or not such party is, albeit implicitly, meant to benefit from the performance of the contract (*Drittbezogenheit des Vertrages*)[93]. Thus, the court stated that "...[D]uties of care can also be created in favour of those persons who are not mentioned by name to the other contracting party. Nor is it necessary that the contracting party should know the exact number of persons to whom a duty of care is owed. [...] It is essential, however, that the group to whom the duty of care is owed should be capable of being determined objectively..."[94].

(3) Foreseeability

Thirdly, liability presupposes that the promisor foresaw or could have foreseen the promisee's protective interest and the third party's proximity of performance at the time of the conclusion of the contract (*Erkennbarkeit*)[95]. It is not necessary, however, that the

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88 Markesinis, Vol. I, *supra* n. 11, at 279

89 Markesinis, Vol. I, *supra* n. 11, at 279; Medicus, *supra* n. 31, n. 844

90 BGHZ 49, 353; Heinrichs in *Palandt supra* n. 5, § 328 n. 16; Markesinis, *supra* n. 61, at 54

91 BGHZ 51, 91 (95); BGHZ JZ 1995, 306 (308); Heinrichs in *Palandt*, *supra* n. 5, § 328 n. 17

92 Heinrichs in *Palandt*, *supra* n. 5, § 328 n. 17; BGHZ 51, 91 (96); Medicus, *supra* n. 31, n. 844

93 BGHZ JZ 1985, 951 et seq.; Medicus, *supra* n. 31, n. 845

94 Cf. reference in Markesinis, Vol. I, *supra* n. 11, at 281; see further BGHZ NJW 1984, 355 (356)

95 BGHZ 49, 354; Heinrichs in *Palandt*, *supra* n. 5, § 328 n. 18; Markesinis, Vol. II, *supra* n. 61, at 54

parties expressly stipulated in the contract who exactly has to be brought under the protective umbrella of the *VSD*. It is only necessary that the promisor could have been able to foresee the protective interest of the promisee for further persons[96].

d) Conclusion

The *VSD* is an emanation of *Treu und Glauben*. It was developed and established in order to overcome the shortcomings of the German tort law and to provide a contractual remedy for 3rd parties who suffered damage because of the promisor's breach of a secondary duty. Courts, however, have always been aware of the fact that the *VSD* essentially means a judicial circumvention of the tort principle of non-compensation for pecuniary loss. Thus, they had to face the difficult question how to define workable parameters in a way that would not totally destroy the notion of contract as a *vinculum iuris* between two persons. These parameters are shaped by § 242 BGB[97]. It must be concluded, thus, that *Treu und Glauben* in the context of the *VSD* protects both the interests of the aggrieved party (compensatory interest) and those of the promisor (limitation of an otherwise unrestricted liability).

5. Collapse of the basis of the transaction

Another notorious example of how good faith impinges upon contracts is the modification of contracts as a result of unforeseen and radical changes of surrounding circumstances, known under German law as the collapse of the basis of the transaction (*Wegfall der Geschäftsgrundlage*; WGG)[98]. The remedy covers a variety of legal problems, namely (a) the change in circumstances that destroyed or made disappear the balance of performance of the parties, (b) the frustration of purpose, and (c) the common mistake. These concepts will be dealt with in the forthcoming. Apart from a few isolated

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96 Markesinis, Vol. I, *supra* n. 11, at 281-2; Medicus, *supra* n. 31, n. 846

97 Markesinis, Vol. I, *supra* n. 11, at 278; Heinrichs in *Palandt*, *supra* n. 5, § 328 n. 14; Gottwald in *Münchener Kommentar*, *supra* n. 13, § 328 n. 80

98 Cf. Lorenz, "Contract Modification as a Result of Change of Circumstances", in Jack Beatson and Daniel Friedmann (eds.), *Good Faith and Fault in Contract Law* (Clarendon Press, Oxford 1995), at 357 et seq.; Markesinis, Vol. I., supra n. 11, at 510 et seq.; Ebke/Steinhauer, *supra* n. 37, at 171 (182 et seq.); Medicus, *supra* n. 31, n. 151 et seq.; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 112 et seq.; Roth in *Münchener Kommentar*, *supra* n. 13, § 242 n. 465 et seq.

rules[99], the legislator refrained from laying down a general principle in this regard.

a) The balance of performance

The first decision upon the question whether or not a contract may be subjected to modifications due to unexpected and supervening circumstances that destroyed or made disappear the balance of the performance (*Äquivalenzstörung*) was handed down by the Reichsgericht in 1919[100]. The defendant had agreed to sell real property which did not yet belong him, but which he hoped to obtain from a partnership which was in process of liquidation because he had given notice of its dissolution. The purchase price was in keeping with the market value of the premises at the time of contracting. However, the liquidation of the partnership was delayed, and, meanwhile, the price of real property increased rapidly owing to the sudden depreciation of currency. The vendor, therefore, regarded himself no longer bound by the contract.

The *Reichsgericht* concurred and found that the depreciation of currency occurring after 1919 had upset the equivalence of performance and counter-performance, which was considered the basis of the transaction[101]. Although, as it has rightly been pointed out, the decision hinged on a "proper distribution of risk on the basis of policy considerations"[102], the underlying concept was that of the adjustment of contracts due to unexpected and supervening changes in circumstances none of the parties was accountable for.

b) Frustration of purpose

Another field in which the *WGG* is applied under German law is that of the frustration of the common purpose of the contract (*Zweckstörung*)[103]. The purpose of a contract is frustrated when performance is still possible, although the creditor has meanwhile lost

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99 See, *inter alia*, §§ 321; 610 BGB. § 321 BGB foresees that a party to a mutual contract who is to perform first may refuse to perform his part until the counter-performance is made or security is given for it. Yet, this rule applies only if a significant deterioration in the financial position of the other party occurs after the conclusion of the contract, whereby the deterioration must virtually endanger the claim for the counter-performance. § 610 BGB allows a person promising a loan to revoke the promise if a serious worsening in the counter-party's financial situation comes about and endangers a claim for repayment.

100 RGZ 103, 328

101 RGZ 103, 328 (333)

102 RGZ 103, 328 (333-4); Lorenz, *supra* n. 98, at 357 (370); Markesinis, Vol. I, *supra* n. 11, at 531

103 Markesinis, Vol. I, *supra* n. 11, at 537 et seq.; Medicus, *supra* n. 31, n. 159-60; Ebke/Steinhauer, *supra* n. 37, at 171 (184); Roth in *Münchener Kommentar*, *supra* n. 13, § 242 n. 617 et seq.; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 144 et seq.

interest in it[104]. The rule in such cases is that the risk generally falls on the creditor[105]. Yet, in appropriate circumstances and in accordance with the dictates of § 242 BGB, exceptions from the rule are acknowledged. This is so when both parties to a contract understand the underlying purpose for which the contract was concluded, and future failure of this purpose may make the contract worthless for the party seeking relief[106].

c) Common mistake

Cases of the common mistake (*beiderseitiger Irrtum*) encompass situations in which both parties err about an existing fact at the inception of the contract[107]. Where both parties are mistaken as to a basic assumption upon which the contract was based, the rules of avoidance (*Anfechtung*) pursuant to §§ 119 et seq. BGB are not to be applied. If they were to be applied, it would depend upon mere chance which party becomes liable for damages: § 122(1) BGB undertakes the avoiding party to compensate the counter-party for damages incurred in reliance of the validity of the avoided contract (*negatives Interesse*)[108]. This "black-or-white result" is considered unjust. Therefore, cases of common mistake are policed by good faith allowing a fair and weighted approach to the issue, but only if the common assumption of the parties had become the foundation of the contract[109]. This, in turn, allows courts to either adjust or avoid the contract, depending on the wills of the parties, on the grounds of § 242 BGB, when the foundation of the contract has disappeared[110] or been disturbed[111]. Consequently, this leads to a non-liability of either party for any expectation damages that the other party may have suffered.

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104 Ebke/Steinhauer, *supra* n. 37, at 171 (184); Roth in *Münchener Kommentar*, *supra* n. 13, § 242 n. 617

105 BGHZ NJW 1984, 1746 (1747); Markesinis, Vol. I., *supra* n. 11, at 538

106 Markesinis, Vol. I, *supra* n. 11, at 538; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 146; Ebke/Steinhauer, *supra* n. 37, at 171 (185); see, for a profound evaluation of this issue, the Bohrhämmerfall (BGHZ MDR 1953, 282; printed in Markesinis, Vol. I, *supra* n. 11, Case 105); the Coronation case (*Krell* v *Henry* (1903) 2 KB 740); Beer to Iran case (BGHZ NJW 1984, 1746)

107 Medicus, *supra* n. 31, n. 162; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 149; Markesinis, Vol. I, *supra* n. 11, at 542; BGHZ NJW 72, 153; the concept of the common mistake is hardly distinguishable from the frustration of purpose: the respective requirements and the legal consequences are nearly identical, so that the terminology is of secondary importance

108 Markesinis, Vol. I, *supra* n. 11, at 543;

109 Markesinis, Vol. I, *supra* n. 11 at 543; Ebke/Steinhauer, *supra* n. 37, at 171 (189); BGHZ 25, 390 (392)

110 BGHZ 37, 44

111 BGH NJW 1976, 565

d) **Requirements**

As one might infer from the cases so far adduced, the collapse of the basis of transaction is a very powerful tool to intervene into contractual stipulations. It has thus to be kept in manageable bounds to reach just and reasonable results that serve both parties to a contract of which the basis has been utterly destroyed or made disappear. For these reasons, the invocation of this remedy is subjected to strict requirements that are by no means easy to comply with, namely (a) a virtual element, (b) a hypothetical element and (c) a normative element[112].

(1) The virtual element

The virtual element (*reales Element*) concerns the ascertainable common assumption, entertained by the contracting parties at the time of the conclusion of the contract, that existent, or the occurrence of future, circumstances form the basis of their transaction. The same applies when an assumption by one of the parties is ascertained or ascertainable by the other without being objected.

(2) The hypothetical element

The second step regards the hypothetical element (*hypothetisches Element*). It requires that the existence or the occurrence of the assumed future circumstance(s) be of primary importance for one of the contracting parties. This must have such an extent that the prejudiced party would not have contracted at all or to less detrimental conditions had s/he had knowledge of the incorrect assumption at the time of the conclusion of the contract.

(3) The normative element

The normative element (*normatives Element*) eventually deals the question whether or not the adherence to the stipulated contract would ask too much of the prejudiced party (*Unzumutbarkeit*). This means that it has to be evaluated on the grounds of good faith whether or not it appears reasonable (aspect of *Redlichkeit*) to undertake the benefiting

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[112] Compare Medicus, *supra* n. 31, n. 165a; BGH NJW 1984, 1746; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 112 et seq.

party to accept the assumed basis of the transaction. Hence, it requires a comprehensive evaluation of the opposing legitimate interests of the disputing parties.

e) Conclusion

The meaning of this legal institution lies not so much in its requirements in terms of the implications of *Treu und Glauben*, but rather in the legal consequences. Whereas a strict application of the Code would lead to unjust "all-or-nothing" results, good faith allows a reasonable allocation of risk and adjustment of the contractual terms for the benefit of both parties where none of them is responsible for the change in circumstances[113]. Accordingly, good faith obliges courts to apply those circumstances the disputing parties would have agreed upon had they known the virtual or foreseen the future circumstances.

6. Conclusion in terms of doctrinal innovations

The legislator empowered the judiciary to create new causes of action on the basis of *Treu und Glauben*. It was clear that an utterly strict adherence to and application of the provisions of the Code and the remedies provided therein would not always lead to reasonableness, fairness and equity. One of the main reasons was – and still is – the flaws of German tort law which has required an extension of contract law.

Through the various extensions, aggrieved parties acquired, apart from a delictual claim, a further, quasi-contractual one on the grounds of *Treu und Glauben*. This has the effect that the rules on contract law have come into play, particularly concerning the recovery of pure economic loss and the shifting of the burden of proof where the promisor breached a secondary duty.

A violation of a secondary duty is only dead letter unless promoted and genuinely protected by law. Such protection has been achieved through good faith and the implementation of the legal institutions– all of which are emanations of the concept – examined above. Hence, § 242 BGB is undoubtedly an indispensable device for the development and refinement of German private law [114].

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[113] Medicus, *supra* n. 31, n. 168; BGHZ 47, 52; BGH NJW 1984, 1746; Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 130

[114] Whittaker/Zimmermann, *supra* n. 17, at 24

It does not only burden the promisor, however, but the promisee as well. The bottom line is that it obliges both parties to consider their conduct carefully and to take into account, amongst other things, the legitimate interests and expectations of the counter-party. If not, *Treu und Glauben* requires a sanction.

VI. Evaluation

The principle of good faith is for a part of legal commentators "the most inadequate and misused principle of civil law in Germany" that has developed into a "legal joker" and allows judges "to patronise the parties will with no limitations"[115]. One can hardly deny the fact that good faith furnishes the judiciary with a powerful device in the ambit of contract law (see above). But it is more than questionable if it turns out to be a legal joker that can be arbitrarily and wilfully applied by judges, given the watchdog role of both the *Bundesverfassungsgericht* and scholars. The *Bundesverfassungsricht* as the guardian of values and principles surveys and ensures the proper and appropriate application of norms and principles in accordance with the ground rules of a state of law. It has the power to overturn any decision that does not comply with these requirements. Additionally, scholarly writings and comments on decisions have an extensive influence upon the creation and the application of law, which also can be inferred from the outline concerning the development and adoption of the "new" causes of action as outlined above. The "legal joker" will thus be kept in manageable bounds.

As can be deduced from the preceding discussion, § 242 BGB has been used by German courts as the statutory basis for generating new legal institutions when existing rules proved inadequate in adjudicating actual cases. Courts have had little difficulty in overcoming statutory limitations and doctrinal hurdles, once convinced that a just result could only be achieved by employing good faith. The source of such law-making has been § 242 BGB, which has been used both as a shield and a sword. The judicial invention of the cause of action for a positive breach of contract and the *culpa in contrahendo* are the most important examples of how judges have utilised good faith as a sword by extending

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115 Reifner, *supra* n. 15, at 269 (307)

the defendant's liability into areas that were not covered by the traditional statutory relieves. The doctrines of frustration of purpose and the change in economic circumstances, by contrast, are examples of cases in which § 242 BGB has been utilised as a shield: it aimed at the just allocation of risks when situations, unforeseen at the time of the conclusion of the contract, emerge to the detriment of one of the parties.

The discussion also shows how judges in a civil law system are more and more frequently engaged in creative interstitial law-making on the basis of the written law. In this respect, German courts are moving in the direction of common law jurisdictions, where judges openly admit that they are making law. Apparently and desirably or not, courts are guided by highly pragmatic and sometimes result-oriented considerations, rather than by slavishly applying principles and rules of law, in order to yield equitable results. The doctrine of good faith is a particularly tempting instrument for interstitial law-making, because it has proved to be flexible enough to respond to novel needs of the German legal system, and firm enough to serve as a foundation even for new causes of action. With regard to equity it has yielded in the ambit of contract law, good faith appears as an indispensable requisite in order to weigh up the flaws of a codified law.

C. Role of good faith in South African law

That good faith plays some role in the development and application of the South African contract law is indisputable and undisputed[116]. Yet, the subject becomes problematic when one endeavours to define its exact role in terms of combating unfairness in the contractual context. In this respect, Cockrell criticises that the concept "as an informing basis of the law of contract has been marginalised" and puts into question whether or not good faith continues "to have relevance as a residual basis for the contemporary South African law"[117]. This question will be dealt with in the following.

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116 *Tucker's Land and Development Corporation (Pty) Ltd* v *Hovis* 1980 (1) 645 (A); Cockrell, "Substance and Form in the South African Law of Contract", in (1992) 109 *SALJ*, at 40 (55 et seq.); Zimmermann, "Good Faith and Equity", in Reinhard Zimmermann and Daniel Visser (eds.), *Southern Cross – Civil Law and Common Law in South Africa* (Clarendon Press, Oxford 1996), at 217 et seq.; Hutchison, Good Faith in the South African Law of Contract", in Roger Brownsword, Norma J. Hird and Geraint Howells (eds.), *Good Faith in Contract: Concept and Context* (The Book Company, Suffolk 1999), at 213 et seq.; v.Huyssteen/v.d. Merwe, "Good Faith in Contract: Proper Behaviour amidst Changing Circumstances", in (1990) 2 *Stell LR*, at 244 et seq.

117 Cockrell, *supra* n. 116, at 40 (55)

I. Historical background

The problem pertaining to the role of good faith as a means to combat unfairness roots in the ancient Roman contract law of which the South African one is a direct descendant. Rome sharply differentiated between contracts *stricti juris* and those *bonae fidei*[118].

Contracts *stricti juris*, the former unilateral contracts, compelled the courts to apply rules of law strictly; the *exceptio* defence was the only remedy available to the plaintiff, either in the form of the *exceptio doli specialis* or the *exceptio doli generalis*[119]. The defendant could invoke the former if the contract was induced by fraud, and the latter when the institution of a suit as such constituted an act of bad faith[120].

Contracts *bonae fidei*, in contrast, did not require a specific procedural device in the form of the *exceptio doli* to check the improper exercise of contractual rights: good faith played a much more direct role since those contracts were based upon *bona fides* of all the parties involved[121]. Accordingly, the *praetor* required courts to decide the matter due to the dictates of good faith ("*negotia bonae fidei*" gave rise to "*iudicia bonae fidei*")[122]. So, the defendant could be judicially absolved from contractual obligations where they had been induced by duress, fraud or any other aspects affecting the *bona fides* of the plaintiff[123].

These consensual contracts eventually superseded the unilateral ones so that all contracts were then treated as consensual contracts. As a consequence thereof, the notion of consensual contracting was employed in Roman Dutch Law and became the basis of South African contract law[124].

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118 For a thorough account of the historical background, see Hutchison, *supra* n. 116, at 213 (215 et seq.); Zimmermann, *supra* n. 116, at 217 (217-20); Lewis, "The Demise of the Exceptio Doli: Is there Another Route to Contractual Equity?", in (1990) 107 *SALJ*, at 26 (30-2)

119 Lewis, *supra* n. 118, at 26 (31); Fletcher, "The Role of Good Faith in the South African Law of Contract", in (1996) *Responsa Meridiana*, at 1 (2)

120 Hutchison, *supra* n. 116, at 213 (216); Zimmermann, *supra* n. 116, at 217 (218);

121 Lewis, *supra* n. 118, at 26 (31); Hutchison, *supra* n. 116, at 213 (216); Fletcher, *supra* n. 119, at 1 (2)

122 Lewis, *supra* n. 118, at 26 (31)

123 Hutchison, *supra* n. 116, at 213 (216); Zimmermann, *supra* n. 116, at 217 (219)

124 Hutchison, *supra* n. 116, at 213 (216); Zimmermann, *supra* n. 116, at 217 (219); Fletcher, *supra* n. 119, at 1 (2)

II. Consensual contracting and equitable defences in South Africa – an overview

Hutchison asks what consequences flowed from the designation of all contracts as contracts *bonae fidei*[125]. A possible inference would be that all contracting parties were "bound to everything which good faith reasonably and equitably demanded"[126] with the result that the Dutch courts "should have had wide powers to read into a contract any term that justice required"[127]. Yet, South African courts repeatedly and continuously resorted to various equitable defences in the course of the 20th Century, namely the *exceptio doli*, public policy considerations and good faith, in order to strike down unfair contracts. Why courts have been doing so, despite the alleged lack of need for the implementation of such a residual equitable device, will be subject of the forthcoming examination.

1. Unfair contract terms and the *exceptio* defence

It has frequently been stated that the *exceptio doli* merely served as a means to introduce into the South African contract law a number of equitable doctrines stemming from English law, such as estoppel, misrepresentation, rectification and so forth[128]. The former defence thus assumed a mere "passport function"[129] (hereinafter referred to as the specific defences). Yet, it has been questioned whether or not the *exceptio* could equally operate as a distinct substantive defence that allows interference with contracts[130].

a) The open application: *Rand Bank*

Given the numerous decisions of the Appellate Division[131], one is inclined to assume that there was still room for a subsidiary equitable defence. Also if much of its potential field of operation was covered by the English-based specific defences, it was repeatedly emphasised that the defence could be employed once a claim has "run the gauntlet of all

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125 Hutchison, *supra* n. 116, at 213 (216)

126 Cf. Joubert JA in *Bank of Lisbon and South Africa Ltd* v *De Ornelas and another* 1988 (3) SA 580 (A),at 601 G

127 Cf. Jansen JA in *Tucker's Land*, at 645 (652 A-B)

128 Cf. Zimmermann, *supra* n. 116, at 217 (221 et seq.); Hutchison, *supra* n. 116, at 213 (218); Fletcher, *supra* n. 119, at 1 (2)

129 See Trollip J in *Connock's (SA) Motor Co Ltd v Sentral Westelike Ko-operatiewe Maatskappy Bpk* 1964 (2) SA 47 (T) 49; Fletcher, *supra* n. 119, at 1 (2); Zimmermann, *supra* n. 116, at 217 (223)

130 See references in Hutchison, *supra* n. 116, at 213 (218 – FN 23); cf. Lewis, *supra* n. 118, at 26 (33); Zimmermann, *supra* n. 116, at 217 (221 et seq.)

131 Wessels JA in *Weinerlein* v *Goch Buildings Ltd* 1925 AD 282, at 292-3; Tindall JA in *Zuurbekom Ltd* v *Union Corporation Ltd* 1947 (1) SA 514 (A) at 535 et seq.;Jansen JA in *Paddock Motors (Pty) Ltd* v *Igesund* 1976 (3) SA 16 (A), at 27-8

other [specific] principles (otherwise the *exceptio* would be mere surplusage)"[132]. Its temporary breakthrough in terms of an open recognition as a distinct defence eventually came in *Rand Bank Ltd* v *Rubenstein*[133]. In his judgement, Botha J held that the plaintiff's conduct constituted a "clear exhibition of bad faith"[134] that required the direct and open employment of the *exceptio*: the circumstances, he stated, were "tailor-made" for its application[135]. The *exceptio* that had always lurked behind the "English doctrines" was thus applied openly and directly for the very first time in South African contract law.

b) The unconditioned abolishment: *Bank of Lisbon*

Possible hopes that the Appellate Division laid down a principle, which allowed courts to interfere with contracts where the defendant raised the *exceptio* defence, were dashed shortly thereafter in *Bank of Lisbon and South Africa Ltd* v *De Ornelas and another*[136]. In this case, Joubert JA felt urged to emphasise that the *exceptio* disappeared when the differentiation between contracts *stricti juris* and those *bonae fidei* was abolished. He saw no need to revive the defence, described it as a "superfluous, defunct anachronism" and gave it the farewell by adding "*Requiescat in pace!*"[137]. In essence, Joubert JA's statement implies that equity cannot override a clear rule of law; the "clear rule of law" was that contracts must be performed according to their terms and regardless of equitable considerations[138].

Jansen JA, however, dissented and was still prepared in his minority judgement to ascribe to the *exceptio* the subsidiary role as a "substantive defence" that finds some room in contract law[139]. Denying the *exceptio* right of place "would leave a vacuum"[140]. What his statements implied – or might have implied – will be dealt with later on.

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132 Judge Jansen in *North Vaal Mineral Co Ltd* v *Lovasz* 1961 (3) SA 604 (T), at 607

133 1981 (2) SA 207 (W) (hereinafter referred to as *Rand Bank*)

134 Botha J in *Rand Bank*, at 207 (215 B-C)

135 Botha J in *Rand Bank*, at 207 (214)

136 1988 (3) SA 580 (A) (hereinafter referred to as *Bank of Lisbon*)

137 Joubert JA in *Bank of Lisbon*, at 580 (607 B)

138 Cf. Zimmermann, *supra* n. 116, at 217 (236); Hutchison, *supra* n. 116, at 213 (221); Lewis, *supra* n. 118, at 26 (26); Fletcher, *supra* n. 119, at 1 (3)

139 Jansen JA in *Bank of Lisbon*, at 580 (617 F-H)

140 Jansen JA in *Bank of Lisbon*, at 580 (616 C-D)

2. Unfair contract terms and public policy: *Sasfin*

Shortly after *Bank of Lisbon*, the Appellate Division decided in *Sasfin (Pty) Ltd* v *Beukes*[141] that agreements containing unconscionable terms are "[...] incompatible with the public interest and therefore contrary to public policy"[142]. The court held that public policy favours on the one hand the utmost freedom of contract, but requires on the other to "properly take into account the doing of simple justice between man and man"[143]. Any agreement that is unduly detrimental to one of the parties does not take into account the simple justice between man and man and is therefore illegal and unenforceable[144]. Public policy considerations were thus applied to strike down unfair contract terms that were grossly exploitive and clearly unconscionable[145]. The gist of the judgement was subsequently corroborated in a number of decisions of the Appellate Division[146].

3. Unfair contracts terms and good faith: *Saayman*

In *Eerste Nasionale Bank van Suidelike Afrika Beperk* v *Saayman NO*[147], Olivier JA was prepared to relieve the aggrieved party from unfair contract terms on the basis of good faith. He described good faith as an indispensable flexible device in the area of contract law, since the function of good faith has always been to give expression to the – ever-changing – community's sense of what is fair, just and reasonable[148]. Any agreement that is contrary to the community's sense of fairness is therefore contrary to good faith and must accordingly not be enforced. Such an interpretation and application of good faith stood in sharp contrast to a statement made by Kotze JA in *Weinerlein*; he opined that "equitable principles are only a force in so far as they have become authoritatively incorporated as rules of law"[149]. Believing that Kotze JA'S view postulated a static, closed system of law based upon rules alone that has lost its capacity to adapt to the ever-changing needs and views of the community, Olivier JA rejected it vehemently[150].

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141 1989 (1) SA 1 (A) (hereinafter referred to as *Sasfin*)
142 Smalberger JA in *Sasfin*, at 1 (13-4)
143 Smalberger JA in *Sasfin* , at 1 (9 G)
144 v.d.Merwe/Lubbe, "Bona Fides and Public Policy in Contract", in (1991) 1 *Stell LR*, at 91 (91)
145 Smalberger JA in *Sasfin*, at 1 (13 J, 14 H-I, 15 E-F)
146 See references in Hutchison, *supra* n. 116, at 213 (224 – FN 63)
147 [1997] 3 All SA 391 (SCA) (hereinafter referred to as *Saayman*)
148 Olivier JA in *Saayman*, at 391 (403 g)
149 Kotze JA in *Weinerlein*, at 282
150 Olivier JA in *Saayman*, at 391 (404 d-h)

4. Conclusion

The implications of the above-mentioned decisions are twofold: on the one hand, it becomes clear that the courts felt the need to take into account communitarian values. Whereas in *Bank of Lisbon* solely individualistic values prevailed, *Sasfin*, in contrast, considered the interests of the other party and the community as a whole. A first step away from a purely self-interested dealing towards a more co-operative one has matter-of-factly been taken by a part of the South African judiciary.

On the other hand, however, the current South African contract law reveals uncertainties as to whether, and especially on what grounds, courts may or may not interfere with contracts unreasonably detrimental to one of the parties. After the unconditioned demise of the *exceptio*, courts resorted to public policy considerations and good faith to strike down unfair contract terms. The possible inference that equitable defences find no room in South African contract law holds apparently not true. The implications of these somewhat contrasting decisions in terms of equity and their effect on the substance of contracts are not entirely clear. Perhaps what the decisions, seen in conjunction with one another, might imply is that the courts are generally prepared to recognise some form of general equitable jurisdiction in order to deal with unfair contract terms, but that the *exceptio doli* was not the appropriate one to sanction bad faith conduct.

III. Public policy and good faith

It is thus put into question if either public policy considerations or good faith are the appropriate devices to accommodate equitable jurisdiction in South Africa. Courts struck down contracts contrary to public policy after the demise of the *exceptio*. With regard to the recent developments outlined above, especially with a view to the *Saayman* case, one has to ask of the interrelationship between the two notions. For this reason, both public policy (under 1.) and good faith (under 2.) will be scrutinised before turning to the issue whether or not good faith possesses any particular relevance in determining issues of public policy within contracts (under 3.).

1. Content and scope of public policy in contracting

Public policy considerations further the utmost freedom of contract[151]. Yet, it is equally recognised under South African contract law that agreements contrary to public policy or incompatible with the public interest are illegal and cannot therefore be enforced[152]. In other words: any contract conflicting with the public interest – that is the respect for law as well as for moral, social or economic values[153] – is to be stricken down on the grounds of public policy. Similarly, van der Merwe and van Huyssteen state that "[S]ociety certainly has an interest in a proper course of affairs between parties who expect it to enforce their private agreement"[154]. Public interest and public policy can therefore be described as determinators of the legality or otherwise of contracts[155]. The difficulty that arises in this context is that one cannot shape public policy any further: it is a dynamic and flexible notion, bound to reflect changing attitudes and may vary due to the course of time and the agreement in question[156].

2. Content and scope of good faith in contracting

Cockrell sees good faith as the "epitome of a legal standard that embodies communitarian values of altruism, care and concern" that has been utilised as an "informing basis of the law of contract"[157]. It allows those who are prepared to adopt those communitarian ideas to develop "areas of the law as disparate as anticipatory breach, cession, pre-contractual duties of disclosure, auction bids, and the contractual relationship subsisting between bank and client"[158]. He expressed further his hope that good faith will also be employed as a general defence aiming at achieving contractual fairness without being restricted to the well-known imported defences. To achieve this goal, it is suggested to firstly recast judicial concepts "in the language of *bona fides*"[159]. This seemingly is in line with Brownsword who fears that, absent a good faith principle, the courts are compelled to

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151 Rabie CJ in *Magna Alloys*, at 874 (889); Zimmermann, *supra* n. 116, at 217 (258)

152 Hutchison, *supra* n. 116, at 213 (222); v.d.Merwe *et al.*, *Contract: General Principles* (1st ed., Juta & Co. Ltd, Cape Town 1993), at 139 et seq.; Zimmermann, *supra* n. 116, at 217 (258); Rabie CJ in *Magna Alloys*, at 874 (890)

153 Hutchison, *supra* n. 116, at 213 (222)

154 v.d.Merwe/v.Huyssteen, "Good Faith in Contract", *supra* n. 116, at 244 (244)

155 Zimmermann, *supra* n. 116, at 217 (258)

156 Zimmermann, *supra* n. 116, at 217 (258); Rabie CJ in *Magna Alloys*, at 874 (891 et seq.)

157 Cockrell, *supra* n. 116, at 40 (55)

158 Cockrell, *supra* n. 116, at 40 (55)

159 Cockrell, *supra* n. 116, at 40 (56)

resort to "contortions or subterfuges" in order to give effect to their sense of the justice of the case[160]. The two authors opine that it is by far more favourable for the courts to simply say that bad faith conduct is legally not permissible instead of having to "conjure up" ingenious strategies to block bad faith conduct. This would result in both congruence on legal terminology and in concentration on the real issues, namely the bad faith behaviour that allows interference with the contracts.

Yet, such an outcome does not give a very detailed definition of what good faith exactly entails. Some hold "the unreasonable promotion of one party's own interests to the detriment of the other contracting party" for bad faith conduct[161]. Others describe good faith as an "ethical value and controlling principle, based on community standards of decency and fairness that underlies and informs the substantive law of contract", thus furnished with a "creative, a controlling and a legitimating or explanatory function"[162].

Apparently, these approaches do not any better in determining what good faith exactly is – and it seems to be the absence of a clear definition that South African writers fear most when being confronted with good faith. Yet, when one wants to exactly determine what good faith is and what it is not, one walks on the wrong path. I presume that neither a universal nor a regional definition exists or is even desirable. The content of good faith is coloured by the particular context and comes across as a dynamic quantity which points also to future developments and circumstances, all of which can only be described at the highest level of abstraction. Its relativity to circumstance, place and time turns it into an inherently indefinable concept that cannot be categorised or sculptured. Bridge has called good faith "a concept which means different things to different people in different moods at different times and in different places"[163], others label it simply a "protean" phrase[164].

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160 Brownsword, "Positive, Negative, Neutral: the Reception of Good Faith in English Contract Law, in Roger Brownsword, Norma J. Hird and Geraint Howells (eds.) *Good Faith in Contract: Concept and Context* (The Book Company, Suffolk 1999), at 13 (25); Brownsword, "Two Concepts of Good Faith", in (1994) 7 *JCL*, at 197 (204)

161 Fletcher, *supra* n. 119, at 1 (1)

162 Hutchison, *supra* n. 116, at 213 (230); v.d.Merwe/Lubbe/v.Huyssteen, "The Exceptio Doli Generalis: Requiescat in Pace – Vivat Aequitas?", in (1989) *SALJ* 106, at 241-2; v.d.Merwe *et al*, *supra* n. 132, at 233; Lubbe & Murray, *Farlam and Hathaway Contract: Cases, Materials and Commentary* (3rd ed., Juta & Co., Cape Town 1988), at 391

163 Bridge, "Does Anglo-American Contract Law Need a Doctrine of Good Faith?", in (1984) 9 *Can.Bus.LJ*, at 385 (407)

164 Bridge, *supra* n. 163, at 385 (387); Farnsworth, "Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code", in (1961) 30 *U.Chi.LR*, at 666 (668)

At least, parts of the judiciary seem to have already accepted the view that good faith is not definable. Jansen JA stated in *Meskin*[165] that good faith is "a concept of variable content"[166]. Hence, once accepted that good faith is indefinable, one can take the second, by far more important step and consider its virtual purpose in the process of legal decision-making: the introduction of equity and communitarian values into the respective laws of contract.

3. The interrelationship between public policy and good faith

It is asked whether or not good faith has any particular relevance when determining issues of public policy in contract[167]. This is even more so since it has been argued that a judicial power to review contracts along the lines of good faith would be unnecessary because contracting parties are sufficiently protected by the laws relating to misrepresentation, mistake, duress, fraud, etc.

Until recently, the answer to the above question would have been a clearly negative one. Many advocated that public policy demanded an utmost freedom of contract, that is free from any judicial interference, regardless of good / bad faith conduct on the part of the contracting parties[168]. This view was best expressed by Hahlo[169]; he stated:

> "[P]rovided a man is not a minor or a lunatic and his consent is not vitiated by fraud, mistake, or duress, his contractual undertakings will be enforced to the letter. If, through inexperience, carelessness or weakness of character, he has allowed himself to be overreached, it is just too bad for him, and it can only be hoped that he will learn from his experience. The courts will not release him from the contract or make a better bargain for him. Darwinian survival of the fittest, the law of nature is also the law of the market-place."

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165 *Meskin NO* v *Anglo-American Corporation of SA Ltd* 1968 (4) SA 793 (W)

166 Jansen JA in *Meskin*, at 793 (804 D)

167 Hutchison, *supra* n. 116, at 213 (222)

168 *Wells* v *SA Alumenite Co* 1927 AD 69, at 73; *Armstrong* v *Magid* 1937 AD 260, at 270; *SA Sentrale Ko-op Graanmaatskappy Bpk* v *Shifren* 1964 (4) SA 760 (A), at 766-7

169 Hahlo, "Unfair Contract Terms in Civil Law Systems", in (1981) 98 *SALJ*, at 70 (70 et seq.)

Smalberger JA, however, dashed in *Sasfin* the categorical adherence to an unlimited freedom and individualistic values, openly displayed in *Bank of Lisbon*, in favour of a more restrictive and communitarian approach. On the basis of the decision handed down in *Magna Alloys*, the judge found that public policy favoured the utmost freedom of contract, but has equally to compete with other values when he referred to "the doing of simple justice between man and man"[170]. The reference to "justice between man and man" is a clear reassertion of the influence of good faith in contracting, re-entering into the area of contract law through the backdoor of illegality[171]. Good faith requires that parties to a contract show a minimum level of respect for each other's interest. The unreasonable and one-sided promotion of one's own interest at the expense of the other infringes the principle of good faith to such a degree as to outweigh the public interest in the sanctity of contracts. Public policy, under these circumstances, requires the courts to refuse to enforce the contract because any conduct contrary to good faith must be branded illegal[172].

The assumption that *Sasfin* marks the landmark case for the reassertion of good faith in contracting and its relevance for determining public policy issues was reaffirmed by Olivier JA in *Saayman* . He reasoned that good faith is an aspect of the wider notion of public policy. Unfortunately, he does not expressly explain how *bona fides* forms an element of an "umbrella concept of public policy". I assume that the basic difference between the two notions is that public policy is applied to equitable standards and views of the society as a whole, while good faith concerns the conduct between the parties involved. It is thus a matter of degree whereby the content does not differ essentially. The assumption is endorsed by Olivier JA's view that the function of good faith in the law of contract has always been to give expression to the community's sense of what is just, fair and reasonable[173]. Hence, courts could – and should – apply good faith to all contracts because the public interest so demands[174]. Accordingly, any conduct or any contractual

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170 Smalberger JA in *Sasfin*, at 1 (9 G); cf. Rabie CJ in *Magna Alloys*, at 874 (890)

171 Hutchison, *supra* n. 116, at 213 (225); Zimmermann, *supra* n. 116, at 217 (259)

172 Hutchison, *supra* n. 116, at 231 (225); Zimmermann, *supra* n. 116, at 217 (259-60); v.d.Merwe/Lubbe, *supra* n. 144, at 91 (97); v.d.Merwe *et al.*, *supra* n. 132, at 160, 234

173 Olivier JA in *Saayman*, at 391 (403g)

174 Olivier JA in *Saayman*, at 391 (406 h-i)

term that is considered contrary to good faith enables courts to interfere with contracts on the grounds of public policy. Good faith ensures "that the law remains sensitive to and in tune with the views of the community"[175].

4. Implications in terms of the role of good faith in contracting

Although many hold that no general equity jurisdiction existed – and still exists – in the South African contract law, I cannot share this view at all. I assume that good faith has always been employed in different disguises as a governing principle in terms of the determination of the legality of unfair contracts. The argument is that once it was recognised that the *exceptio* was not the appropriate "disguise", the judiciary was then "compelled" to accommodate notions of general equity in the aspect of public policy in order to yield fairness. This would serve South African contract law in two different ways. On the one hand, good faith would still play a decisive role in the decision-making process concerning contractual disputes, despite *Bank of Lisbon*. One the other hand, it would generate judicial consistency in terms of law making without back stabbing the decision of the Appellate Division handed down in *Bank of Lisbon*, thus preventing the judiciary from being undermined by its own body.

a) Jansen JA's "preparatory works" in Bank of Lisbon

The assumption roots in Jansen JA's reasoning in his minority judgement in *Bank of Lisbon* as alluded to above. The judge held that the *exceptio* as a substantive defence was based on the sense of justice of the community, and therefore closely related to and even overlapping with defences based on public policy[176].

There remains, however, the question what Jansen JA might have wanted to express regarding the interrelationship between good faith, public policy and the *exceptio*. Hutchison analysed Jansen JA's passage as reference to the "clearly established principle that a court may treat as void and unenforceable any contractual provision that is against

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175 Olivier JA in *Saayman*, at 391 (407 g-h 410 i); compare Hutchison, *supra* n. 116, at 213 (226); v. Huyssteen/v.d.Merwe, *supra* n. 116, at 244 (248), where they held that "[S]ociety certainly has an interest in a proper course of affairs between parties who expect it to enforce their private agreement"

176 Jansen JA in *Bank of Lisbon*, at 580 (617 F-H)

public policy or contrary to good morals[177]. This is certainly true; yet, what Jansen JA could additionally have meant is that the *exceptio*, could, once demised, be replaced or absorbed by defences based on public policy or even by the public policy rule. This assumption is endorsed by the rule itself: public policy embraces the standards of good faith and thus takes into account and stays in tune with the views of the community. Hence, it promotes equity-based and community-oriented jurisdiction, irrespective of the fact that it had authoritatively become incorporated as rules of positive law or simply continued to flourish upon the seeds that already have been sown by its precedents. It thus seems as though public policy is invoked to overcome the common general principle prohibiting courts from interfering with contracts on grounds of fairness and equity when one of the specific doctrines lacks applicability. Once the element of public policy is employed, courts are able to rove freely over the question of fairness.

It is therefore presumed that Jansen JA, in view of the apparently inevitable abolishment of the *exceptio*, opened up the door widely for future courts and judges to transfer the peculiarities of the defence, viz to transfer aspects of fairness and equity, into either already established or future concepts. This objective has subsequently been realised by, *inter alia*, Smalberger JA in *Sasfin* and Olivier JA in *Saymaan*.

b) Evaluation

One can infer from the pronouncements on the interrelationship between good faith, public policy and the *exceptio* that good faith fleshes out the *exceptio* defence and public policy considerations alike. This means that any bad faith conduct on the part of a contractant enables courts to strike down contracts on the grounds of good faith, at present in the guise of public policy. Therefrom follows that, *Bank of Lisbon* notwithstanding, good faith has always been and is still present in South African contract law.

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177 Hutchison, *supra* n. 116, at 213 (222)

It is thus assumed that the Appellate Division and the Supreme Court of Appeal have been able to find a way to gallantly circumvent the (undesired) rejection of a free-floating good faith principle in the framework of the South African contract law. The employment of the public policy rule has enabled courts to successfully absorb under its broad "umbrella" the elements of the *exceptio* defence, namely the good / bad faith standards. For these reasons, I do not concur with van der Merwe and Fletcher considering that the absence of the defence has left a void in the South African law of contract[178]. From my point of view, the *exceptio* has been absorbed rather than replaced by public policy immediately after its demise, which ensured that good faith still played a vital role pertaining to the legality of contracts; thus, there has virtually never been such void. Time will rather tell whether the absorption is only a temporary and intermediate measure until South Africa will eventually be prepared to allow an open, direct application of good faith as the governing standard in contracting.

Against this background, I conclude that the, at first sight contrasting, positions taken by the Appellate Division in terms of fairness or equity are not virtually contrasting ones. They rather have to be understood in a way that the *exceptio doli* was not the appropriate tool to sufficiently provide all the answers to questions on achieving fairness and equity in cases other than those to which the specific doctrines apply. In contrast thereto, the Appellate Division and the Supreme Court presumably consider the public policy rule as the current appropriate device in this respect, in all likelihood because and as long as good faith is not accorded the judicial legitimisation to openly interfere with contracts.

D. Reservations in terms of the implementation of an open good faith principle

Good faith has always formed an (indirect) part of the South African contract law, formerly in the "disguise" of the *exceptio* and then as an informing concept of public policy. In view of this fact, the question springs immediately to the mind of a foreigner who has to deal with good faith in his daily life why the South African majority is still not

[178] v.d. Merwe *et al*, *supra* n. 132, at 232; Fletcher, *supra* n. 119, at 1 (5)

prepared to allow an open good faith-interference with contracts. As a matter of fact, many reservations have been brought forward in this regard. All of them tend to oppose the idea to concede good faith the role of an overriding and free-floating principle that governs the entire contract law. For this reason, I will scrutinise and evaluate some of the arguments that militate against its incorporation. Because of space constraints, the forthcoming examination only deals the aspect of legal uncertainty (I.), the aspect of creativity (II.), the introduction of extra-legal principles (III.) and the aspects of individualism and altruism (IV.). Regard in this context will be partly given to the German experiences with the principle.

I. Aspect of legal uncertainty

Many criticise that good faith spells too much legal uncertainty and overwhelms the judiciary with excess litigation[179]. The broad applicability of the concept and its relativity towards time, place and circumstance make them believe that good faith will detract from legal certainty. No one can deny that legal certainty is important for any participant in law-related matters. Perhaps, certainty is especially important given the exorbitant cost of litigation and the necessity for lawyers to adhere accurately to the law, in particular when advising clients, in order to avoid such expense. If a court is given review power, it means in practical terms that it possesses the power to re-make the contract and relieve one party of its obligations, sometimes to an extent that it may frustrate the legitimate expectation of the other one. One would thus be in the wary position of not knowing what good faith might do to a contract; legal uncertainty is thus the logical, but unwanted consequence. Not even in Germany, commentators on § 242 BGB fail to issue anxious warnings to lawyers and judges who might be tempted to use the concept in a facile fashion at the expense of perhaps more awkward, but also more certain lines of legal reasoning[180]. The reference to uncertainty caused through good faith compels attention to be paid to the doctrines applied instead thereof in South Africa. I suggest that the arguments against a

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179 Fletcher, *supra* n. 119, at 1 (11-2); Lewis, *supra* 118, at 26 (37 et seq.); Lubbe/Murray, *supra* n. 162, at 463

180 Compare Heinrichs in *Palandt*, *supra* n. 5, § 242 n. 2: "keine Ermächtigung zu einer Billigkeitsjustiz"; Roth in *Münchener Kommentar*, *supra* n13, 242 n. 1-30; Reifner, *supra* 15, at 269 (286-7): the "Emperor's clause"

direct employment of good faith only holds when the South African contract law is equipped with devices that serve the same function in a more precise manner.

1. Legal certainty and contract interpretation

As alluded to above, good faith in the relevant criterion for the interpretation of contracts under German law, see §§ 133, 157 BGB. Through these norms, courts are given the power to impute upon parties their view of things, regard being paid to the thoughts of an objective bystander.

South African contract law approaches the question of contract interpretation in a quite similar fashion with good faith as the relevant determinative criterion[181]. The general rule is that courts are not empowered to depart from the clearly expressed intentions of the parties. Yet, as soon as the wording is ambiguous or uncertain, the courts make clear that words cannot be looked at in isolation[182]. They must rather be read within the context of the contract as a whole, under consideration of the surrounding circumstances and factors known to the parties at the time of contracting[183].

Authority reveals that South Africa favours the linguistic approach, meant to serve the quest for legal certainty. Once the parties have reduced their contract to writing – and if there is no ambiguity in its provisions – they ought to have a document on which to rely in regulating their relationship. Yet, when the wording is ambiguous, normative rules of interpretation come into play: "considerations of fairness and policy contribute to the shaping of contractual content"[184]. The theoretical basis for this appears to be the flexible notion of good faith[185], which empowers courts to decide the case due to the particular circumstances. Such an approach approximates to the German one.

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181 Zimmermann, *supra* n. 116, at 217 (242)

182 Innes CJ in *Trustee, Estate Cresswell & Durbach* v *Coetzee* 1916 AD 14, at 19; Innes CJ in *Richter* v *Bloemfontein Town Council* 1922 AD 57, at 69-70; compare further *Van Rensburg* v *Straughan* 1914 AD 317 (326)

183 Diemont JA in *List* v *Jungers* 1979 (3) SA 106 (A), at 118, 120; Lubbe/Murray, *supra* n. 162, at 463

184 Zimmermann, *supra* n. 116, at 217 (243); v.d.Merwe/Lubbe, supra n. 144, at 91 (98-9). Due to space constraints, I will not undertake a detailed discussion regarding those factors, such as the use of extrinsic evidence, tacit and implied terms and policy considerations, but rather refer to the comprehensive analysis of Zimmermann and v.d.Merwe/Lubbe.

185 Zimmermann, *supra* n. 116, at 217 (243); Lubbe/Murray, *supra* n. 162, at 464, 469; v.d.Merwe *et al.*, *supra* 132, at 219

2. Legal certainty and interference with contracts

Both public policy and good faith principally enable courts to interfere with contracts. Such ability conflicts in the first place with the principle of *pacta sunt servanda*, which, in its strict application, leads to an utmost legal certainty[186]. The unrestricted employment of that principle preserves a contract from being altered in the aftermath and requires parties and judges to rigorously enforce the contract according to its stipulations. Whereas Germany recognises that the principle competes with other concepts, such as *Treu und Glauben*, the view came only gradually to the fore in South Africa[187]. Nowadays, it is acknowledged, however, that the concept *pacta sunt servanda* is by no means absolute and immutable, but subjected to public policy considerations[188].

a) Arbitrary non-recognition of good faith as limiting device

Given that South African courts are willing to interfere with and strike down contracts contrary to public policy, it can be seen that there is no cogent argument against the use of general principles in judicial decision making. Public policy is a no less vague term than and even fleshed out by aspects of good faith. It gives expression to the community's sense of what is fair, just and reasonable[189]. Any unfair, unjust and unreasonable terms is deemed illegal and has accordingly to be struck down on the grounds of public policy, and not, as one might have expected, on the grounds of good faith. Whereas public policy concerns the values and standards of the community as a whole[190], good faith, equally based on community standards of decency and fairness[191], directly evaluates the conduct of the parties involved against the background of what the community regards fair, just and reasonable. Since good faith directly concerns the stipulations of the contract, it appears as the far more suitable instrument to govern cases of indecent and unfair contracting.

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186 § 145 BGB; Markesinis, Vol. I, *supra* n. 11, at 516; Fletcher, *supra* 119, at 1 (10)

187 See Zimmermann, *supra* n. 116, at 217 (240) where, he concluded in view of Sir George Jessel MR's statement in *Printing and Numerical Registering Co.* v *Sampson* (1875) LR 19 Eq 462 (465), that the private autonomy of contracting parties must be accorded paramount importance.

188 Jansen JA in *Bank of Lisbon*, at 580 (613 B); Cockrell, *supra* n. 116, at 40-63; Fletcher, *supra* n. 119, at 1 (10)

189 Jansen JA in *Bank of Lisbon*, at 580 (617 F-H); Olivier JA in *Saayman*, at 391 (406 h-i)

190 Hutchison, *supra* n. 116, at 213 (222)

191 Hutchison, *supra* n. 116, at 213 (230)

Yet, the direct application of good faith has so far been rejected in favour of a public policy approach. The application of public policy, however, renders the South African contract law no more transparent that good faith would do. Hence, it becomes apparent that the South African contract law has not been able to implement a concept empowering courts to interfere with contracts that is less diffuse or vague than the concept of good faith. Thus, the argument against good faith in terms of legal certainty is untenable; the recognition of public policy and the simultaneous non-recognition of good faith as a policing device seem rather arbitrary and, thus misplaced.

b) Further examples of vague terms

Apart from public policy, courts have previously been prepared to interfere with contracts on the grounds of a clear exhibition of bad faith[192], unconscionability[193], or referred to "grossly exploitive" terms that "offended against the mores of the public"[194]. With all due respect, these terms or concepts are by no means less vague than good faith. The argument against good faith for being too uncertain is thus to be rejected.

In terms of the specific doctrines, it must be stated that they also remain undefined, except to the extent that courts will announce, in a given case, whether or not a set of facts comes under a particular doctrine. But while this approach maximises judicial discretion to decide a case on its merits, it also maximises uncertainty, since the (non-)application of such doctrine will often seem arbitrary, especially when and where a specific doctrine has no precise limits.

c) The use of vague terms in South African tort law

A further example reveals that South African law is already well-acquainted with vague terms. In the area of tort law, an act, which causes harm to another, gives rise to delictual liability if the prejudice was caused in a wrongful manner[195]. The general criterions in the determination of wrongfulness are the "legal convictions of the community: the *boni*

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192 Botha J in *Rand Bank*, at 207 (215 B-C)

193 Wessels JA in *Weinerlein*, at 292-3; Tindall JA in *Zuurbekom*, at 535 et seq.; Jansen JA in *Igesund*, at 27-8

194 Smalberger JA in *Sasfin*, at 1 (13 J, 14 H-I, 15 E-F)

195 Neethling/Potgieter/Visser, *Law of Delict* (3rd Ed., Butterworths , Durban 1999), at 35

mores"[196]. The *boni mores* test is an objective test based upon the criterion of reasonableness. To ascertain whether the infringement of one's rights was reasonable or not, courts are bound to weigh up the conflicting interests of the defendant and plaintiff "*ex post facto*" in light of all the relevant circumstances and in view of all pertinent factors[197]. The *boni mores* or general reasonableness criterion is a juridical yardstick, which gives expression to the prevailing convictions of the community regarding right or wrong. It is a criterion which enables the court continuously to adapt the law to reflect the changing values and needs of the community[198]. The reasonableness test is undisputedly accepted in tort law, despite or rather because of its vagueness. The use of open terms enables courts to deal with situations and circumstances unforeseen at the time when law was made and to subsume the merits of a specific case thereunder.

Yet, the terms are no less vague than those utilised to describe the sphere of applicability and the content of good faith. It is startling, however, that these vague criteria are accepted and applied in tort law, and at the same time regarded as insufficiently precise and clear in contract law when one speaks of the meaning of good faith. The distinction between tort law on the one hand and contract law on the other regarding the application of similar or identical criteria seems arbitrary and unjustified, especially when one thinks of the precept of the uniformity of law (*Einheit der Rechtsordnung*)[199].

3. Evaluation

In conclusion, I feel the concerns for certainty are somewhat misplaced. At present, there is virtually no higher degree of certainty under South African law than it would exist if one openly implements the principle of good faith. Good faith admittedly is an open term. It has rightly been warned that "[E]mploying *bona fides* to effect contractual justice on an

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196 Neethling/Potgieter/Visser, *supra* n. 196, at 37-8; *Administrateur, Natal* v *Trust Bank van Afrika Bpk* 1979 (3) SA 824 (A), at 833-4; *Schultz* v *Butt* 1986 (3) SA 667 (A), at 679

197 Neethling/Potgieter/Visser, *supra* n. 196, at 38-9; *Coronation Brick (Pty) Ltd* v *Strachan Construction Co (Pty) Ltd* 1982 (4) SA 371 (D), at 380

198 Neethling/Potgieter/Visser, *supra* n. 196, at 38-9

199 The reasoning only concerns the applicability of open terms as such and not their content with regard to the respective field of law. Hence, the dispute whether or not the application and the content of a specific term differs according to what field of law is employed is of no importance here. Neethling/Potgieter/Visser clarify the difficulties that, for example, may arise when one applies the *boni mores* test in the law of delict and equally in criminal law. They opine as follows: "Because the law of delict is only concerned with the legal permissibility of infringements of *individual* interests, the application of he boni mores test in the law of delict is not determined by the question whether the particular act should be considered wrongful for purposes of, for example, criminal law (where the *public* interest is paramount), cf. Neethling/Potgieter/Visser, *supra* n. 196, at 42

individual level would place considerable strain on legal certainty"[200]. This is indeed a concern, which would place a great responsibility on the courts. However, just because a word needs to be interpreted in a context does not mean that it is ambiguous or uncertain. Much of the meaning of good faith will necessarily depend on the context of the contract. This is not a weakness, but strength, and should alert judges to the need to take into account the intentions of the parties, intentions which will be heavily context dependent.

II. Aspect of creativity

In terms of creativity, it is said that there is no need to introduce good faith into the South African contract law in order to vest courts with a creative tool, as it is necessary in Germany. Under German law, the application of good faith through § 242 BGB was primarily designed to overcome the apparently immovable and otherwise ossifying obstacle of nominalism enshrined by the Code. It thus serves the purpose of innovation and creativity in terms of the development and implementation of doctrinal innovations. Yet, its creative and innovative role does not militate *per se* for its transplantation into the South African law system that does not have to "struggle" with the strict precepts of a Code. In a largely case driven system with only very limited statutory intervention, the courts have the freedom to develop the law as and how they see fit. In the absence of a code, there is no need to ground the judicial development of law in the "statutory interpretation" of a general clause. It is rather acknowledged that the creative role is inherent in their judicial function[201]. Consequently, it is held that case driven legal systems have not lost their dynamic potential in the same way as it might have happened with codified law regimes and there is no corresponding need to fly for relief to the general clauses. But this is not exactly true. Stripped to the essentials, the ability of South African judges to create law solely and exclusively derives from general principles, which form the basis of the art of distinguishing. Why, then, would good faith not also be a valuable principle in South African contract law? Given that good faith underlines and informs the South African contract law, it must be concluded that the judge's power to

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200 v.Huyssteen/v.d.Merwe, *supra* 116, at 244 (251)

201 McKendrick, "Good Faith: A Matter of Principle?", in A.D.M. Forte (ed.) *Good Faith in Contract and Property* (Hart Publishing, Oxford 1999), at 39 (41 et seq.); Zimmermann, *supra* n. 116, at 217 (220); Jansen JA in *Tucker's Land*, at 645 (652); Joubert JA in *Bank of Lisbon*, at 580 (601)

create law is to a large extent based upon the general doctrine of good faith. Thus, it assumes an indispensable creative role, as it does in Germany as well. The main argument that the best kind of legal creativity emerges within the disciplined boundaries of a continuos legal tradition does not reveal a great deal of creativity, but rather that of conservatism. The rejection of good faith on the grounds that courts are already vested with creative powers, being inherent in their function, is thus not tenable: their creative powers are virtually based upon good faith.

The difference between South Africa and Germany in terms of creativity is by no means as big as one might think at first sight. The BGB conception of good faith is one of potentially universal application to contracts. The German judge starts with the assumption that, if the situation requires it, s/he will be able to deploy the principle of good faith to resolve it. The manner, however, in which the principle has been developed by German courts, has some strong parallels with the development of doctrines of equity in South Africa. Much of the potential uncertainty in the operation of equity is resolved by creatively breaking the concept down into distinct doctrines, such as (promissory) estoppel or undue influence controlled by precedent, as alluded to above. In a similar fashion, the potentially very wide scope of good faith might be expected to produce uncertainty in the interpretation of contracts, in the creation of new causes of action and in judiciary intervention. But this is not in fact how the German courts have operated. In their interpretation and development of good faith, they have broken down that principle into various smaller, more specific doctrines, such as, *inter alia*, the *culpa in contrahendo*, positive breach of contract, impracticability, frustration of purpose and the collapse of the foundation of the transaction. Hence, it is not the general clause but the case law of the German courts, which creates the rules[202]. So while a general principle of good faith was introduced into the Code, its content was, and still is, creatively determined by the exposition of German judges and jurists. It is applied by the mediation

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202 Markesinis, "The Legacy of History on German Contract Law", *Foreign Law and Comparative Methodology: A Subject and a Thesis* (Clarendon Press, Oxford 1997), at 90; Wieacker, *A History of Private Law in Europe* (Clarendon Press, Oxford 1995), at 411

of intermediate doctrines, and hence not so far away from the South African way of application.

III. Introduction of extra-legal principles

Another objection to the adoption of good faith is that such principle introduces extra-legal aspects, namely economic and moral values, that are said to find no place in legal reasoning. That this objection is not substantiated will be shown in the ongoing.

1. Introduction of economic values

It is feared that good faith introduces into the law of contract economic aspects governing the question whether or not courts may be empowered to intervene with contracts in the general pursuit of justice, order and a fair balance between conflicting interests in a legal system.

a) The Laissez-faire capitalism and its rejection

Courts have traditionally held a strong faith in *laissez-faire* capitalism, presupposing that the self-interest of the parties will determine the market, and the operation of the unfettered free market will in turn lead to the promotion of the common good as understood in utilitarian terms[203]. The presumption is that the market is sacrosanct, because what is good for the market is good for society at large. The employment of concepts of private autonomy and respect for consensus appear to further this presumption. Van Huyssteen and van der Merwe, however, convincingly contend the thesis; they find that "[T]he law of contract is not concerned with protecting individuals in a selfish pursuit of personal interests: it recognises interests in both their individual and social context"[204]. Accordingly, society requires that agreements should respect broader values of which economic ones form a part[205].

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203 Compare R.H.Campbell/A.S.Skinner, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Oxford, 1976), ch. IV.1.10

204 v.Huyssteen/v.d.Merwe, *supra* n. 116, at 244 (245)

205 v.Huyssteen/v.d.Merwe, *supra* n. 116, at 244 (246); Lubbe/Murray, *supra* n. 162, at 20-6

b) Individualistic theory and theory of the superior risk-bearer

As to the individualistic theory of contract, the loss should be borne by that party incurring it, also if it is contrary to its contractual expectations: the loss remains where it falls. This only would guarantee the absence of a restraint of trade. The individualistic approach, however, disregards the fact that contract law is additionally concerned with economic efficiency. Yet, this objective can only be achieved when one considers both economic and legal aspects simultaneously. To clarify and to exemplify the issue, van Huyssteen and van der Merwe examine the "test of the superior risk-bearer" which allows a reasonable allocation of economic risks[206]. According to the test, any contractant who, objectively, is better placed to prevent the materialisation of loss, or to make provision for the necessary means for countering the results of a risk which does materialise, is deemed the superior risk-bearer. A seller, for instance, who undertakes to deliver goods shall *prima facie* bear the risk should the delivery fail. S/he is in the better position to pre-estimate the harmful consequences of a failure to perform due to the contractual specifications, and thus typically required to make provision for the prevention of loss. This kind of allocation of risks is to be achieved through the taking into account of economic considerations on the basis of a good faith approach.

c) Conclusion

It goes without saying that the operation of law cannot be entirely reduced to the mere application of economic considerations. This would inevitably lead to the unwanted and undesirable situation that law could not provide for the reasonable adjudication of conflicting (both economic and legal) interests. But this is not exactly the point. No one doubts that, apart from economic considerations, there are other important, legal factors[207] to be taken into account in the pursuit of justice and in the realisation of economic efficiency. The suggestion rather is that good faith in this context offers the ability to allocate simultaneously both economic and legal considerations and so allows a reasonable and just evaluation of the contrasting, but legitimate interests of the parties

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206 v.Huyssteen/v.d.Merwe, *supra* n. 116, at 244 (246);

207 Let alone factors such as duress, undue influence or fraudulent behaviour

concerned. Accordingly, the "test of the superior risk-bearer" provides a good and valuable example of how legal *and* economic considerations impinge upon contract law.

2. Introduction of moral values

It is furthermore feared that good faith would introduce elements of morality into contract law. The traditional standpoint based upon the concept of the autonomy of law is that morality and law should be kept separate: thus, contracting should not be subjected to moral constraints[208]. Yet, this standpoint hardly reflects at least today's legal reality and is therefore obsolete and untenable: law, in its present form, by no means exists in isolation from the rest of society's values but rather forms part thereof. Contract law is not morally neutral, neither in South Africa nor in Germany. Therefore, moral values impinge to a large extent upon law in general and contract law in particular, as will be shown in the forthcoming.

a) South African contract law and moral values

In terms of South African contract law, this has been made clear on numerous occasions. In the view of Jansen JA, the remedy of the *exceptio* was a substantive defence, based on the sense of justice of the community. As such it was closely related to the defences based upon public policy or *bones mores*. The need for the *exceptio* was still prevalent since the concept of *bones mores* has not as yet been specifically applied in the field of contract law[209]. What he was referring to was the clearly established principle that a court may treat as void and unenforceable any contractual provision that is contrary to good morals[210]. Hence, morality impinges to a large extent upon law and is by no means kept separate and isolated therefrom.

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208 Cf. v.Huyssteen/v.d.Merwe, *supra* n. 116, at 244 (248, FN 23); Brownsword, Reception, *supra* n. 160, at 13 (38)

209 Jansen JA in *Bank of Lisbon*, at 580 (616 C-D, 617 F-H); see further Lewis, *supra* n. 118, at 26 (34)

210 Hutchison, *supra* n. 116, at 213 (222)

b) **German contract law and moral values**

With regard to the German law, the outcome in terms of the interrelationship between morality and law is hardly different. Conflicts between general values and good morals[211] are governed by the German Civil Code in § 138(1) BGB and in § 826 BGB. § 826 BGB creates the obligation to pay damages if a person intentionally, wrongfully and culpably causes harm to somebody else in contradiction to good morals[212], whereas § 138(1) BGB foresees that any legal transaction contrary to good morals is void[213]. The latter provision thus develops the idea that the freedom of contract is embedded into a general legal order by referring to good morals which includes § 134 BGB[214] as a special case wherein the legislator himself defined the public policy which should prevail over the parties' consent.

c) Conclusion

What one can infer from this brief outline is that the principle of good morals confers upon courts the power to define boundaries to the freedom of contract. It helps state and community to defend their goals against the parties acting contrary to what the community regards as good morals, in other words: to admit the freedom of contract inside a certain legal territory. It thus requires that the parties act freely, but not without trespassing the outer boundaries of a legal order, which is defined by society and the state. In contrast, good faith helps the parties in cases of disagreement about the true meaning of a contract to achieve their proper goals with respect to general habits and standards[215]. The fear, that good faith introduces aspects of morality into the field of contract law, is thus groundless: moral values form already part of both the South African and the German contract law and work in conjunction with other values and principles, irrespective of the employment of good faith.

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211 Also if the translation of "good morals" with "*gute Sitten*" is widely accepted, one should stress that it is not quite correct:the term "*Moral*" exists in the German language and is used separately from "*Sitten*". "*Moral*" is not used as legal term because its subjective attitude is distinct from law, which always appeals to the community as a whole. The correct translation of "*Sitte*" would be a habit that concerns generally accepted values or perhaps habits of decency or fair play.

212 "*Wer in einer gegen die guten Sitten versoßenden Weise einem anderen vorsätzlich Schaden zufügt, ist dem anderen zum Ersatze des Schadens verpflichtet*"; § 826 BGB, however, will not be subject matter of the forthcoming discussion.

213 "*Ein Rechtsgeschäft, das gegen die guten Sitten verstößt, ist nichtig*"

214 § 134 BGB foresees that a legal transaction is void if it is in contradiction with a statutory obligation ("*Ein Rechtsgeschäft,das gegen ein gesetzliches Verbot verstößt, ist nichtig, wenn sich nicht aus dem Gesetz ein anderes ergibt*")

In terms of economic values, the case is a bit different. Introduced upon the basis of good faith, they have to be taken into account in the assessment of unfair contract terms, but only in competition with other, primarily legal values and standards. What must be made clear, however, is the fact that economic values must not prevail over legal principles, but only supplement them.

IV. Individualism / Altruism

Good faith, where applied, introduces communitarian values into the respective contract law to that extent that (would-be) contracting parties are undertaken to take into account each other's interests during the process of negotiation, performance and enforcement of the contract. Reservations of law systems that favour self-interested dealing might be encountered when the question is answered to what extent a party is allowed to put her/his own selfish interests above those of the contractual partner in view of a good faith standard. In other words: how does good faith impinge upon self-interested dealing?

1. Germany as an example of an altruistic law system

From the outset, it has to be made clear that, even in Germany as an example of a law system in which the altruistic model of contract prevails over the individualistic one, none of the parties is obliged to prioritise the other's interests over one's own. Self-interested dealing is by no means substantively affected; it equally underlies the altruistic model. The sole constraint, altruistic ideas – and thus good faith – would lay upon self-interested dealing, is the fact that the parties respect one another's legitimate interests. This, in turn, means that self-interested dealing is compatible with the doctrine of good faith as long as legitimate interests of one's counter-party are taken into account in the course of negotiation, performance and enforcement.

2. Good faith constraints on self-interested dealing

Closely connected therewith is the question to what extent good faith constraints self-interested dealing. Again, one cannot give one simple and static answer to that question,

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[215] Heinrichs in *Palandt*, *supra* n. 116, § 242 n. 19; Reifner, *supra* n. 15, at 269 (285); BAG NJW 1964, 1543

given the dynamic and creative character of that concept. It is necessary to take into consideration the surrounding circumstances of each peculiar case, including, in particular, the kind of the (envisaged) contract and the primary and secondary obligations pertaining thereto: such contractual obligations indicate the degree of interests the other party has therein. Brownsword convincingly illustrates the general applicable rule in this respect. He finds that "[t]he more extensive a party's legitimate interests are taken to be, the greater the constraint imposed by good faith; the less extensive, the less the constraint on the pursuit of self-interest"[216]. This eventually leads to the presumption "that different conceptions of good faith hinge upon different conceptions of legitimate interest"[217].

3. Determination of legitimate interests

Yet, Brownword fails to give a detailed answer as to *what* legitimate interests have to be taken into account in order to comply with a good faith standard in situations other than those when a stipulated contract was induced by duress, fraud or incapacity. As a general rule, the contract must satisfy the standards of bargaining in good faith[218]. The mere fact that the bargaining powers of the contracting parties are unequal is clearly not a sufficient ground for its violation[219]. The starting point for the determination of legitimate interests with a view to a good faith standard is thus the stipulated contract and the promisee's expectation interest connected therewith. The promisee's expectation interest clearly concerns the receipt of the benefit promised by the contract; this includes the expected costs to the promisor consisting of opportunities foregone at the time of the conclusion of the contract. Good faith adds nothing, unless one party is accorded discretion in performance and thereby controls the other's anticipated benefit[220]. The discretion is exercised in good faith when it is exercised for any purpose within the reasonable contemplation of the parties[221]. It is broken, however, where there is any deliberate conduct on the part of one part, which interferes with the risk and benefit exchange as contemplated by the contract. Hence, the legitimate interests of the parties are defined by

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216 Brownsword, Two Concepts, *supra* n. 160, at 197 (211)
217 Brownsword, Two Concepts, *supra* n. 160, at 197 (211)
218 Adams, "The Economics of Good Faith in Contract", (1995) 8 *JCL*, at 126 (131)
219 Adams, *supra* n. 219, at 126 (127-8)
220 Adams, *supra* n. 219, at 126 (132)
221 Compare in the regard the examples given in Adams, *supra* n. 219, at 126 (132-3)

the their respective contract which leads to the fact that one cannot give an all-embracing and absolute definition of what the notion of legitimate interests encompass.

4. Conclusion

As soon as one admits the consideration of the legitimate interests of the other party, however, it inevitably leads to the recognition of communitarian values in the realm of contract, as it has already been admitted in *Sasfin*. Against the background of the reasoning in *Sasfin*, one has thus to contemplate that the aspect of individualism has been abolished and replaced by considerations of altruistic ideas in South African contract law. Accordingly, even this objection against good faith as the mediator for the introduction of communitarian values is nowadays obsolete.

V. Evaluation

The objections examined here towards the adoption of a good faith principle in the framework of the South African contract law are either obsolete or untenable. For these reasons, it must be hoped that the seeds that have already been sown out will not fall on barren ground that would leave South Africa in the same unsavoury position in terms of equity and judicial decision-making. An open recognition of good faith would lead not only to legal consistency, but also to a coherent reasoning without employing other concepts or doctrines that have to be bent beyond recognition in order to generate equitable results.

E. Advantages in terms of the implementation of good faith in South Africa

After it has been worked out that the objections brought forward against the employment of good faith are either obsolete or untenable, I will present five arguments that support the implementation of good faith into the South African contract law, despite the suspicion of general doctrines[222], the preference for "piecemeal solutions"[223] and the

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222 Joubert JA in *Bank of Lisbon*, at 580 (610); see references in Hutchison, *supra* n. 116, at 213 (217)

223 Term used by Sir Thomas Bingham in *Interfoto Picture Library Ltd* v *Stiletto Visual Programmes Ltd* [1989] QB 433, at 439

existence of the specific doctrines. The assumption that they virtually cover a wide range of bad faith conduct, however, is undisputed, and comprehensively scrutinised by Zimmermann[224]. But also if there is nothing intrinsically objectionable against the recognition of a good faith doctrine, one might wonder why a law system should incorporate an indefinable concept of equity when equivalent results can be achieved by the means already entrenched in the South African law system[225]. On analysis, however, such indifferent position proves inadequate, as will be revealed in the following.

I. Good faith directly addresses the problem

South African law already tries to regulate bad faith dealing in a manner that courts feel empowered to strike down contracts or terms thereof either whenever the defendant's conduct is regarded inconsistent with public policy[226], when there is a clear exhibition of bad faith[227], or in cases of unconscionability[228]. Whatever term has been employed by the courts, it was founded upon the notion of good faith whose elements then indirectly and covertly came into play and so permeated the South African contract law. In terms of transparency of the law, however, it would be more rational to address the issue in question directly and openly, viz whether or not a conduct amounted to bad faith conduct that allows interference on the grounds of good faith[229]. The direct and open addressing of the issue in question on the grounds of good faith would accordingly prevent the courts from resorting to "contortions or subterfuges in order to give effect to their sense of the justice of the case"[230].

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224 Zimmermann, *supra* n. 116, at 217 (221 et seq.)

225 the so-called pragmatic or indifference thesis, see Brownsword, Reception, *supra* n. 160, at 13 (21-2); Brownsword, Two Concepts, *supra* n. 160, at 197 (198)

226 Smalberger JA in *Sasfin*, at 1 (13-14); Olivier JA in *Saayman*, at 391 (406 et seq.); Rabie CJ in *Magna Alloys*, at 874 (890)

227 Cf. Botha J in *Rand Bank*, at 207 (215 B-C)

228 Cf. Wessels JA in *Weinerlein*, at 282 (292-3); Tindall JA in *Zuurbekom*, at 514 (535 et seq.); Jansen JA in *Paddock Motors*, at 16 (27-8); see further the English authorities: *Evans* v *Llewellyn* (1787) 29 ER 1191; *Frey* v *Lane* (1888) 40 Chancery
Div 312, establishing the principle of court intervention where unconscionable clauses form part of the contract

229 Cf. Summers, "Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code", in (1968) 54 *Virginia L.R.*, 195 (198-9) who maintains that "[without a principle of good faith, a judge] might be unable to do justice at all, or he might be able to do it only at the cost of fictionalising existing legal concepts and rules, thereby snarling up the law for future cases. In begetting snarl, fiction may introduce inequity, unclarity or unpredictability. In addition, ficton can divert analytical focus or even cast aspersions on an innocent party"

230 Powell, "Good Faith in Contracts", in (1956) 9 *Current Legal Problems*, at 16 (26); Brownsword, Reception, *supra* n. 160, at 13 (25)

II. Ill-equipment of the law of contract without good faith

Some venture the view that contract law in general is ill-equipped to achieve fair results, on occasion leaving judges unable to do justice at all in the absence of good faith[231]. Also if, at first sight, this argument is hardly convincing, it can be developed in different ways. First of all, good faith might operate as a free-floating and overriding device impinging upon the entire law (of contract) to the effect that any legal subject has to abide by it and in cases of its violation suffer the consequences. In terms of the South African contract law, Hutchison, *inter alia*, opines that there is as yet no such general doctrine[232].

Good faith could be invoked to cover, unify and fill the gaps that might have occurred during the negotiation, performance or enforcement of the contract to secure fair dealing and to advance a minimum of mutual respect. Then, in hard cases (those that supposedly make bad law), judges could appeal to good faith to justify a one-off decision, to adumbrate some new principles of fairness, or to extend the range of an already recognised principle that was not originally meant to embrace the dispute in question. This argument is even more convincing when one takes into account that law is a dynamic body that has to adjust itself daily to the requirements of society. So, the range of equitable estoppel might be extended into the sphere of pre-contractual liability for the wrongdoer by good faith, which is achieved through the *cic* under German law. Additionally, one could think of characterising economic pressure, when it has reached a certain degree, as a form of duress[233].

A second feature in terms of the umbrella principle is that what Brownsword describes as the need to "resort to contortions or subterfuges"[234] in the absence of good faith in order to give effect to the courts' sense of justice in the specific case. With a good faith principle, courts would be capable to hand down judgements without having to stretch and manipulate existing resources which might be sometimes the case without the recognition of such overriding principle. What is even more important is the fact that judges, who might, in the absence of good faith, feel bound by authority to hand down

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231 Brownsword, Reception, *supra* n. 160, at 13 (26); Summers, *supra* n. 230, at 195 (198-99); Powell, *supra* n. 231, at 16 (26)

232 Hutchison, *supra* n. 116, at 213 (230); v.d.Merwe et al, *supra* n. 132, at 233; Working Paper 54, at (iii), para. 2

233 Economic considerations are, among others, important features in equitable contract law, see v.Huyssteen/v.d.Merwe, *supra* n. 116, at 244 (247); Bridge, *supra* n. 163, at 385 (411); Lorenz, *supra* n. 98, at 357 et seq.

234 Brownsword, Reception, *supra* n. 160, at 13 (25); see further Powell, *supra* n. 231, at 16 (26)

judgements after the motto "hard cases yield hard decisions", would be furnished with a tool to avoid such harsh decisions and employ equity-based considerations.

III. Good faith responses to reasonable and varying expectations

If one takes into account the numerous and various modes of contracting and the parties' expectations, it seems much more favourable to appeal to good faith rather than to the respective specific remedy offered by law that might, as the case may be, unsuitable and inappropriate under the concrete circumstance. Instead of dealing with the question what exact remedy is applicable to the case, a good faith principle would allow to directly deal the core of the dispute, posing more immediately questions of contractual interpretation and implication in a context of what the parties concretely expected from the contract. It thus would give effect to the spirit of the deal in a way that prioritised the parties' own interests and expectations[235].

IV. Good faith contributes to a culture of trust and co-operation

That good faith is able to contribute to a culture of trust and co-operation can be inferred from the scenario that a certain imaginary society has not yet developed any kind of contract law. It is presumed that in such "lawless" environment, dealing would be of a very defensive nature: mutual performance would be conducted at the same place and at the same time for reasons of utmost security for the promisee. This, in turn, means that the more a party to a contract is awarded security in terms of contractual benefit and the counter-party's conduct, the more the former is prepared to alleviate control over its part of the transaction. If, then, a counter-party attends only to its own interests and tends to maximise its own outcome, that party would face difficulties in the "market" and hardly find a partner willing to conduct transactions when "competitors" deal according to the maxim of constrained maximisation [236]. This scenario can easily be transferred into the sphere of contract law: the more a party is accorded security in dealing and safeguarded against the risks of unconstrained maximisation, the more willing it is to enter into contracts with third parties. Good faith offers such a security; it advances co-operative

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[235] Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men", in (1997) *LQR* 113, at 433 (439)

dealing and aims at optimising both parties' interests and reciprocal expectations in an environment of mutual trust and mutual risk, allowing courts to strike down contracts or terms thereof if inconsistent therewith.

V. Good faith and national and international convergence

Another fundamental assumption concerns a feature that I will describe as the convergence thesis[237]. In the current movements towards internationalisation, liberalisation and globalisation, not only industrial nations are supposed to converge towards similar socio-economic structures. Consequently, socio-economic convergence makes uniformisation of law as a primary objective to appear simultaneously possible and desirable. The globalisation of the markets and computerisation of the economy will lead to a convergence of economic regimes and to a functional equivalence of legal norms. The problem one encounters when one thinks of globalisation, and accordingly harmonisation, is that there exists no global society as such. It rather comes across as a corpus that ties up closely only with some of its areas, only on specific occasions and only to different fragments of society[238]. Today's society does not present itself to law as a unity of nation, language and culture, but rather as a fractured multitude of social systems which allows accordingly only or discrete linkages with these fragments. Because of its open and indeterminable character, the reasoning on the basis of good faith helps to harmonise these apparently fragmented structures and allows an interpretation that takes into account the specific needs of a specific community. This specifically concerns South Africa in two different ways, both nationally and internationally.

1. The national level

Firstly, on the national level, South Africa consists of a multitude of different cultures, customs and languages. This bears the inherent danger of a further social fragmentation and pluralisation if one applies different doctrinal solutions or rules or positive law to

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236 Compare example in Brownsword, Reception, *supra* n. 160, at 13 (32)

237 Cf. Clark Kerr, *Industrialisation and Industrial Man* (Cambridge, Mass: Harvard University Press, 1960); Basil Markesinis, "Learning from Europe and Learning in Europe", in B. Markesinis, *The Gradual Convergence: Foreign Ideas, Foreign Influences, and English Law on the Eve of the 21st Century* (Clarendon Press, Oxford 1994), at 30

238 Teubner, "The Two Faces of Janus: Rethinking Legal Pluralism", in (1992) 13 *Cardozo Law Review*, at 1443

similar or equal (contractual) disputes. Invoking good faith in said situations, despite or literally because of its indeterminacy, courts may play a decisive role in the transformation process from a selective and fractured legal society towards a unified society to which the same (good faith) standard applies.

2. The international level

On the international level, in contrast, it becomes increasingly clear that South Africa will have to deal with good faith in the near future, an assumption for which the United Nations Convention for the International Sale of Goods (CISG; the Vienna Convention)[239] provides a good example. Although South Africa has not yet acceded to the CISG, its norms and leading principles to disputes arising out of international contracts of sale are already applicable to many contracts involving South African traders in the international arena[240]. One of the leading principles that is of major concern for this thesis is exposed in art. 7(1) CISG. The provision foresees that "[I]n the interpretation of this Convention, regard is to be had to [...] the observance of good faith in international trade". Hence, at least on the international trade level, South African traders and domestic courts alike are required to adapt to and confront themselves with a good faith standard, albeit in terms of a mere contract interpretation.

VI. Evaluation

As it has been pointed out, there are at least five cogent arguments for the incorporation of a doctrine of good faith into the South African law of contract. It allows a clear, coherent and effective addressing of the problem in terms of unfair dealing, brings law much more closely into alignment with the protection of reasonable expectations, and contributes to a culture of trust and co-operation. All this might enhance the autonomy of contractors and could amount to an important factor of successful economies, the more so because South Africa is already confronted with good faith on the international level.

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239 which came into force in January 1988

240 Its adoption is highly promoted by academics, cf. Hugo, "The United Nations Convention on the International Sale of Goods", (1999) 11 *SA Merc LJ*, at 1 (3); Eiselen, "Adoption of the Vienna Convention for the International Sale of Goods (The CISG) in South Africa", (1999) 116 *SALJ*, at 323 (342 et seq.)

F. Conclusion

On the basis of the preceding examination, I must conclude that the introduction of good faith into the South African law of contract is a desirable goal from which the participants in contracting and courts alike will benefit. Possible and understandable concerns in this respect will be alleviated as soon as case law on the good faith issue grows; this fact can be inferred from the German case law, which forms the basis of today's adjudication.

It must be emphasised, however, that one cannot simply transplant good faith from one jurisdiction into another. One rather has to take into consideration the respective peculiarities of each law system so that good faith will interact productively with other elements, such as morality, in the "legal organism". Otherwise, as Teubner rightly warns, one risks that the principle will be rejected "by an immune reaction" of the domestic law system[241]. This is so because when a foreign rule is imposed on a domestic culture, it would work "as a fundamental irritation which triggers a whole series of new and unexpected events. It irritates the minds and emotions of tradition-bound lawyers" and "law's binding arrangements. It is an outside noise, which creates wild perturbations in the interplay of discourses within these arrangements and forces them to reconstruct internally not only their own rules but to reconstruct from scratch the alien element itself"[242]. Thus, "they cannot be domesticated"[243].

Good faith, however, is a flexible device that has the ability to adapt to legal systems that are as yet unfamiliar with the concept, literally because of its flexibility. The only difficulty that arises when such principle becomes introduced is the need to recast the legal language, especially in terms of the reformulation of the established doctrines of contract law[244]. Whether a reformulation of the legal language might cause the feared "immune reaction" is yet more than doubtful. In all likelihood, a recast legal jargon will create transparency, consistency and stringency in judicial reasoning so that good faith will be "domesticated", rather than "rejected".

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241 Teubner, "Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences", in (1998) 61 *MLR*, at 11 (12)

242 Teubner, *supra* n. 242, at 11 (12)

243 Teubner, *supra* n. 242, at 11 (12)

244 Cockrell, *supra* n. 116, at 40 (56); Teubner, *supra* n. 242, at 11 (12)

It the transplant of good faith into the South African contract law comes across as a "good faith requirement" or a "good faith regime"[245] is not of primary importance. In the long run, however, the goal of South Africa should be to adopt a regime (a default position) that expressly imposes upon contracting parties modes of good faith conduct, which, in cases of its violation, empowers courts to strike down contracts. In this regard, Brownsword suggests to simultaneously accord contracting parties the right to agree upon the exclusion of such good faith regime in the framework of their transactions, so assuming the role of a "facilitative measure"[246]. Yet, German law does not allow the parties to displace good faith; it is an absolute value that has to be regarded and respected in any legal act. Otherwise, the principle would denigrate to a mere nutshell, only designed to promote the interests of the party with strong bargaining powers to the costs of the weaker one. Nonetheless, as alluded to above, good faith has the ability to adapt to different legal systems; thus, where it is held that partial exclusion is necessary, good faith will allow to do so. The fear in terms of the flexibility can therefore equally turn out to be an advantage.

With regard to the German experience with good faith as a means to govern unfair contracts, I propose to adopt the principle in South Africa as well, given the advantages the principle will bring. The time is right for good faith to be elevated to a position from where it can operate against substantive, and if necessary, procedural unfairness in contracts. Contract law has without any doubt achieved efficiency, and now it should focus on aspects of equity and fairness on the highest possible level.

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245 Brownsword, Reception, *supra* n. 160, at 13 (35 et seq.); Hutchison, *supra* n. 116, at 213 (232) opines that South Africa already has a good faith requirement

246 Brownsword, Reception, *supra* n. 160, at 13 (36)

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