

A Commentary on the Meaning of Objective Good Faith in the Translex Principles through International Arbitration: a Law & Economics Approach

Um comentário sobre o significado de boa-fé objetiva nos princípios da Translex por meio da arbitragem internacional: uma abordagem a partir do Direito e da Economia

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Abstract

Despite its numerous enunciations, the meaning of objective good faith remains obscure. The usual manner in which legal scholars have attempted to provide for such meaning is by presenting a definition of the general principle of good faith into more general principles, such as fairness. Objective good faith, as presented in the Translex Principles does not escape from this problem. This theoretical reflection attempts to provide for such a meaning in this particular codification. This will be achieved by means of the findings of economic institutionalism, paying attention to the transaction costs that potentially arise in context of wide information asymmetries, at which point, it is the objective of institutions to reduce said asymmetry. In international commercial transactions, opportunistic behavior is ripe. There is a demand for a legal institution that is able to, directly or indirectly, curtail opportunistic behavior, which from the standpoint of legal studies is equated to bad faith. In this sense, objective good faith is identified with a general legal institution, the aim of which is precisely to limit opportunistic behavior. From it more specialized legal institutions are born, its concretization being possible partly possible by the practice of international arbitration, contributing thusly to transnational law.

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Keywords: objective good faith; transnational commercial law; New Law Merchant; international arbitration; opportunistic behavior.

Resumo

Apesar de seus numerosos enunciados, o significado da boa-fé objetiva permanece obscuro. A maneira usual pela qual os juristas têm tentado fornecer esse significado é apresentando uma definição do princípio geral de boa fé em termos mais gerais, como justiça. A boa-fé objetiva, conforme apresentada nos Princípios Translex, não escapa desse problema. A presente reflexão teórica tenta identificar tal significado nesta codificação particular. Isso se dará por meio das constatações do institucionalismo econômico, atentando-se para os custos de transação que potencialmente surgem em contextos de amplas assimetrias de informação. Portanto, a redução dessa assimetria é um dos objetivos das instituições. Nas transações comerciais internacionais, o comportamento oportunista poderá estar presente. Exige-se uma instituição jurídica que seja capaz de, direta ou indiretamente, coibir comportamentos oportunistas, o que do ponto de vista dos estudos jurídicos é equiparado à má-fé. Nesse sentido, a boa-fé objetiva se identifica com um fundamento jurídico geral, cujo objetivo é justamente limitar o comportamento oportunista. Dele nascem instituições jurídicas mais especializadas, sendo a sua concretização possível em parte pela prática da arbitragem internacional, contribuindo assim para o direito transnacional.

Palavras-chave: boa fé objetiva; direito comercial transnacional; New Law Merchant; arbitragem internacional; comportamento oportunista.

Introduction

The general objective of this paper is to shed some light onto the question of the meaning of objective good faith as it is enunciated in the Translex Principles (henceforth, the Principles), and how international arbitration contributes to a degree in the process of making it operational. Methodologically, this will be done by means of law & economics, in particular: with the aid of the findings of economic institutionalism, paying attention to those transaction costs that potentially arise in context of wide information asymmetries, at which point, it is the objective of institutions to reduce these costs. In such contexts –of which international commercial transactions are a prime example- there is a high propensity to opportunistic behavior. There is a demand for a legal institution that are able to curtail opportunistic behavior, which, from the standpoint of economics, is equated to bad faith. In this sense, objective good faith is identified with a general legal institution, the aim of which is precisely to limit opportunistic behavior –and from which additional legal institutions, with the same, but more specialized aim, can be logically deduced.

Even though the findings of this work pertain principally to the Principles, they can be applied to additional transnational commerce law –such as the UNIDROIT Principles or any other codification attempt of transnational commercial law. The Principles, however, have

been first and foremost chosen for their particularly dynamic nature. It is a digital codification on the internet, constantly being updated with the latest commentaries and decisions –from both national and international arbitrators and judges by a team of scholars of the University of Cologne (CENTRAL -University of Cologne, n.d.).

It should be mentioned, however, that this paper does not provide for a detailed discussion, nor an explanation, on the specific process through which international appointed arbitrators create new rules using the objective good faith clause. Its objective is more moderate, inasmuch as it presents both the meaning of objective good faith in the Principles, and argues that, without it, international arbitration could not contribute to transnational commercial law –which, controversial as it may be, it does. The emphasis of this work is placed rather on the critical importance of the open rule that is the objective good faith provision in the Principles in the expected contribution to transnational commercial law on the side of international arbitration. In this sense, this work opens the door for further research.

Beyond this brief introduction, the concept of objective good faith will be presented as a negative concept, functioning as an institutional tool to exclude sets of bad faith behavior. Within Section 3 good faith will be explained as a negative concept, while section 4 presents a law& economics dissertation of objective good faith as an anti-opportunism in contract law. Section 5 provides a discussion on the “utility” of the open rule of objective good faith within international transnational commercial law codifications efforts such as the Principles, and the role international arbitration plays building from the bottom the inner system of good faith. Lastly, Section 5 concludes.

The enunciation of objective good faith

To the question of what are the principles and rules composing what has come to be known as the New Law Merchant (henceforth, NLM), the Translex creeping codification of the Principles attempts to provide for an answer (Berger, 2019). Among the more than 130 principles and rules of international law that it gathers, and presents with their corresponding commentaries, objective good faith is one of those. Rule No. I.1.1 of the Principles states that observance of the principle of good faith shall not be waived by the parties to a contract, and that they should not limit its application, prescribes that parties to an international contract *must act in accordance with good faith* and fair dealing -and that such imperative is expected to be observed during all contract stages -the negotiation, formation, performance, and interpretation of the contract (Berger, 2019).

Primarily in civil law systems, objective good faith can be summarized as not taking advantage of a contractual position in situations that might lend itself to it (Mackaay, 2012, p. 154). As a key concept, it is argued that it is a principle capable of creating, modifying and extinguishing legal relationships. It allows the judge or arbitrator, in some cases, to deviate from the wording of the contract or applicable contract law, whenever that the application of either of these would result in opportunistic behavior -or inefficient risk allocation.

Up until the moment this text is being written, there is no work casting doubt upon the importance of the objective good faith. However, its meaning as enunciated in the Principles – as in the many enunciations presented by many civil law compilations- is far from clear. Most attempts to clarify it have been simply unsuccessful, as they appear to translate what could be a general term into other general terms to which without question objective good faith is related -such as fairness and honesty. As an apparent principle, objective good faith appears to be capable of justifying almost any rule of contract law. Such could be the case of §242 BGB, according to which an obligor has a duty to perform according to the requirements of good faith. As a general provision, it suffuses all the law of the contract (Heinrich, 2006; Hennrichs, 1995; Wieacker, 1956). Furthermore, having no clear enough meaning could lead to the conclusion, that it is a kind of general mold, a sort of open rule, in which more specific doctrines can be cast, then to assume an independent existence within the positive law of different legal systems (Mackaay, 2012, p. 159) –and within codifications of transnational commercial law such as the UNIDROIT principles.

In short, objective good faith is related to the honesty the parties shall exercise toward each other -in terms of revealing critical pieces of information that would determine contract perfection. In this sense, a lack of a clear meaning of the concept runs the risk of rendering the notion simply not operational, eventually resulting in a market for lemons *a la* Akerlof (1970) at an international level.²

Objective good faith as a negative concept

Keeping up the search for meaning, one interesting position is to see objective good faith as a sort of cradle rule, from which judges create additional rules in order to supplement, limit and qualify other specific legal rules and contract terms (Summers, 1968, p. 198). If it is admitted for the sake of argument, that judges do in fact have a duty to create legal rules – regardless of the clarity of this duty, by invoking good faith, it may be possible for judges to do justice in a contract relationship, in which one of the parties has taken unduly advantage of the other one precisely in a situation that has lend itself to it; and in which strict compliance of the wording of the contract would result in an absurd outcome -like inefficient risk allocation. Without such a resource, justice might be achieved by the judge, as the case analyst, but probably at the cost of raising uncertainty for future legal cases, as the rule would not logically derive from any graspable principle (Summers, 1968, p. 198). Notwithstanding, when the judge is trying to impose a specific duty of good faith to one of the contract parties, the meaning of the decisions runs the risk of not being timely grasped. Regardless of the manner in which the judge is using the term, there may be still some lack of clarity surrounding the

² For example, in long distance international transactions, if potential parties come to expect that acting dishonestly has no clear way of affecting the obligations of a contract, if they are considerably risk averse, parties will only differentiate between potential business partners in terms of price. Being wealth maximizers as they are, and thus preferring only those partners offering lower prices, high quality partners would see themselves forced to copy the strategy of the low price suppliers, which could entail offering goods and services of a lower quality. Hence, high quality potential business partners are squished out of the market, leaving behind mostly low quality sellers. Furthermore, another visible effect would be that parties, interested in avoiding becoming victims of opportunistic behavior, could opt for the costliest choice, which would be forgoing contracting altogether, with clearly overall diminishing welfare consequences.

expression “acting in good faith.” In this sense, it could be argued that the purpose of unveiling the meaning of good faith is better served by asking: *what is it that the judge is called upon to rule out -in the real or hypothetical situation, whenever he is invoking objective good faith?*

What the judge is seeking to rule out are sets of bad faith behaviors (Summers, 1981, p. 196). Once the relevant form of bad faith is identified, a specific meaning to good faith can be assigned by formulating an opposite for the species of bad faith being ruled out. For example, a judge may say that the seller must act in good faith when transferring the property title to the buyer. From the language of the case, or its facts, it could be that the judge is actually saying: *that the defendant acted in bad faith because he did not disclose critical pieces of information in time, that would support the purchase decision by the claimant.* It could be said, that, in this particular case, acting in good faith means: complying with a general and obvious duty to lessen the asymmetry of information that is pervasive at contract formation in favor of one of the parties (Summers, 1968, p. 201). It would follow that, in contract law, good faith is better understood as an *excluder*; a phrase without a meaning of its own, but useful nonetheless to rule out a wide range of distinct forms of bad faith behaviors. In a particular context, the phrase takes on specific meaning, but only by way of contrast -with the specific bad faith behavior identified for later on being ruled out (Summers, 1968, p. 201).

This particular excluder approach, it turns out, is reflected to a considerable degree in the enunciation presented by the Principles, specifically in Rule No. I.1.1. According to it, parties to an international business transaction must act in good faith. By implication, the principles should be interpreted in a way in which each party has the obligation to display a behavior toward the other one, which *cannot harm it*, having this one formed reasonable expectations about the performance of that one. Furthermore, the parties have to display a *normal* degree of honesty and sincerity, which is reasonable for the safeguard of the party’s interests, particularly in trying not to act in a way that potentially is to unduly surprise or to inflict damages to the other party (Trans-Lex, 2019). The rule also prescribes that the standards and requirements imposed on the parties by the principle of good faith vary depending on the individual circumstance involved, such as the trade sector in which the parties are operating, or the nature and duration of the contract. This implies that the application of the good faith principle always requires a determination of what is deemed to be an improper conduct of a party, taking a case-by-case approach.

Law & economics approach to objective good faith

a) Bad faith as opportunism

While useful, the approach consisting in understanding objective good faith as an excluder still begs the question of operational meaning for bad faith. Let us say from the start, that our intention is to present bad faith as being equal to opportunism. It operates as opportunistic behavior. Hence, objective good faith operates as a limitation for opportunistic behavior across and during contract stages. The operation meaning of objective good faith is founded upon such limitation.

In order to do just that, it is essential to gain a better insight into the notion of *expectation interest* –which is, after all, an element referenced within the enunciation of good faith as presented in the Principles (Trans-Lex, 2019). It traditionally comprises property, services, or money to be received by the promisee upon entering a contract (Schäfer & Can Aksoy, 2015, p. 3). On the other hand, it also encompasses the costs of performance by the promisor. These expected costs are composed of the forgone opportunities upon entering a particular contract (Burton, 2017, p. 372). Paying attention primarily to these costs of performance by the promisor becomes essential to the proper understanding of good faith as opportunism.

Bad faith performance occurs precisely when *discretion* is used to recapture opportunities forgone upon contracting – as when the party exercising discretion bare the expected costs of performance. In turn, good faith performance occurs when the discretion conferred onto the party is used within the reasonable contemplation of the parties at the moment of contract formation. In other words, acting in good faith is equivalent to capturing opportunities that were preserved upon entering the contract. The good faith doctrine therefore directs attention to the opportunities forgone by a discretion-exercising party at contract formation, and to that party’s reasons for exercising discretion during performance. It is because of this reason that bad faith is equated to opportunism (Burton, 2017, p. 373). In order to identify if bad faith behavior constitutes a breach of contract³ attention must be paid to the eventual fact that the promisor used his discretion to recapture said forgone opportunities –while complying with the wording of the contract (Burton, 2017, p. 378; Houh, 2003, p. 22). Independently of how this discretion is conferred upon (Burton, 2017, p. 380), the dependent party must rely on the good faith of the other, *controlling* party. Only in such cases, the judge can expressly invoke the implied covenant of good faith, or interpret a contract in light of good faith performance.⁴

Deferred decision as to time of performance, for instance, may allow one party to determine when it shall perform; when the other party shall perform; or when the contract shall end. Often such decisions are expected to be executed in good faith. When such deferred decisions are made, the dependent party then is left to the good faith of the party in control. In turn, bad faith consists in an exercise of discretion in performance to recapture forgone opportunities at the moment in which the contract is formed. The expectations of the dependent party encompass both the subject matter to be received under a contract, and the expected costs of performance by the other party. A recapture by one party of forgone opportunities necessarily harms the other. A reasonable person, accordingly, would enter a contract that confers discretion to the other party only on the belief that such discretion will not be used to recapture forgone opportunities (Burton, 2017, p. 387).

³ Objective bad faith performance is only capable of modifying, creating, or supplementing a contract obligation if it is considered a breach of contract. It would only be such, if in important aspects it resembles a breach by failing to perform as expressly stipulated in the contract.

⁴ According to Burton (2017, p. 380), discretion “*in performance arises in two ways. The parties may find it to their mutual advantage at formation to defer the decision on a particular term and to confer decision-making authority as to that term onto one of them. Discretion also may arise, with similar effect, from a lack of clarity or from an omission in the contract.*”

2) Opportunism

In contract law, bad faith can be equated to opportunism; and good faith to abstention from opportunistic behavior (Muris, 1980, p. 566)⁵. The key here is to focus on the *involuntary* transfer of wealth that occurs, when the controlling party exercising discretion behaves contrary to the dependent party's understanding of the contract, but not necessarily contrary to the explicit terms of the agreement (Muris, 1980, p. 522). Because of such an involuntary transfer of wealth, parties experience incentives to avoid becoming victims of opportunism. Yet, whatever strategy they choose, deterrence will be achieved at a cost. Many legal doctrines, it follows, appear to be efficient means of deterring opportunism, when compared to the costlier option of self-protection by the potential victims. Good faith can be understood as one of such doctrines (Mackaay, 2012, p. 161).

In the law & economics literature, there are a number of particular forms of opportunism such as: free riding, shirking, agency problems (Carnahan, Agarwal, & Campbell, 2008, pp. 1451–1563), moral hazard (MacKenzie, Ohndorf, & Palmer, 2012, pp. 350–374), etc. Institutionalism places opportunism in an important, central role. Williamson defines it as self-interest seeking with guile (1985, pp. 64–67); a concept opposed to trust, and closely linked with partial disclosure of critical information, with uncertainty, with bounded rationality; and with self-disbelieved promises about the opportunist's own future conduct. It is an effort to realize individual gains through a lack honesty in transactions, being the most common form the strategic disclosure of asymmetrically distributed information by individuals to their advantage (Williamson, 1973, p. 317).

The reason why good faith is to be observed during all stages of an international contract, within the Principles, is because opportunism potentially affects all of them, and hence, it is one particular phenomenon with which contract law should concern itself (Cohen, 1992, p. 957). If opportunistic behavior is left unchecked, it would lead to all potential contract parties to raise their guards, taking more extensive measure against becoming victims of opportunistic behavior. The ultimate precaution would be forgoing the contract altogether, which is surely the costliest option. If such choice is adopted by many contractors at an international level, this would shrink the market. Precautionary measures short from abstaining from contracting are wasteful relative to social welfare. Defending against opportunistic behavior is a primary responsibility of the contracting parties. Certain legal systems could, however, be useful by allowing contracting parties to reduce their self-protection and loss-absorption costs. Where, and if, this can be accomplished at a cost of the rule itself and its enforcement that is lower than the savings generated, we could expect such gains where public authorities have access to greater scale economies in framing and enforcing rules that are open to private actors (Mackaay, 2012, p. 166).

⁵In order to make operational the concept of opportunistic behavior as being opposite to objective good faith, Mackaay and Leblanc (2003) have developed a test, which consists in identifying "*an asymmetry between the parties; which one of them seeks to exploit to the detriment of the other in order to draw an undue advantage from it; the exploitation being sufficiently serious that, in the absence of a sanction, the victim and others like him or her are likely substantially to increase measures of self-protection before entering into a contract in the future, thereby reducing the overall level of contracting.*"

3) Good faith as anti-opportunism in contract law

On account that there are always innovative forms to behave opportunistically, the argument could be stressed that contract law needs an open-ended set of responses to it. Over time, legal systems have developed a variety of specific concepts to deal with particular forms of opportunism. Consider the case of fraud (or *dolus*), defined as any trick to deceive a person (Mackaay, 2012, p. 166). In this sense, consider one of the UNIDROIT Principles, according to which *a party may avoid the contract when it has been led to conclude it by the other party's fraudulent representation*, including language or practices, or fraudulent non-disclosure of circumstances which, according to reasonable commercial standards of fair dealing, the latter party *should have disclosed*. Reference is being made here to the basic idea of opportunism in terms of strategically failing to disclose asymmetrically distributed critical pieces of information (Williamson, 1973, p. 317). In it, the party has the right to step aside from the contract, which he would never have entered it, had he not been deceived by erroneous or incomplete information provided by the other party.

The example of fraud is appropriate if it is thought of as: aiming to deter opportunistic behavior by manipulation of the information by one of the parties. Accepting opportunism as the reasoning underlying fraud, for instance, directs attention to new factual patterns that might be relevant to curtail opportunism, as other individual actions could be identified as related to such patterns. By doing this, as new cases are presented to courts and to codifiers – probably consolidating the courts' efforts – these broaden the existing formula to cover closely related forms of opportunism. Gaps are then filled marginally at the edge of existing concepts, and the result thereof are legal institutions, that can be identified as *anchors* to good faith –composing what has come to be known as the inner system of rules and duties within the good faith concept. These serve the purpose of keeping legal uncertainty within acceptable boundaries, contributing to the broad legal objective of curtailing opportunism (Mackaay, 2012, p. 168), while providing for important limitations for discretionary decision making by the judiciary. Institutions such as *laesio enormis*, fraud or *culpa in contrahendo* are important elements of such inner system, on account that are derived from the general clause of good faith.

However, occasions may arise where the opportunistic behavior being faced is not covered by any of the elements within the inner system –as developed so far in positive law. For such occasions, it becomes useful to count on an open-ended concept, capable of being applied, as a last resort to new forms of opportunism. The duty of good faith plays precisely this last resource function. The duty to act in good faith is applied as a rule of last resort in exceptional cases, in the expectation that this will lead in due course to the crystallization of a new concept; a new anchor applicable to a specific set of problems, as has happened with *culpa in contrahendo* in German law (Mertens, 2003). This anchoring process may be operated by the courts under the general cover of good faith. It may also be undertaken by legislation. Lastly, at an international level, it may also be undertaken by codification efforts such as the

one undertaken by the Principles, resulting from the systematization efforts by legal scholars identifying different groups of cases from the general practice of international arbitration.

The role of the duty to perform in good faith as an anti-opportunism tool in the Principles

Even though it is presented as a rule, the good faith provision in the Principles does not contain one in the same sense as Civil Codes do. It presents no facts to which it applies, nor any legal effect; neither of these are even capable of being established from the wording of the provision itself. Hence no clear logical deduction can be advanced with it to the point of a logical conclusion, presenting a legal consequence deriving from a set of facts. Notwithstanding, it is in fact a rule -an open rule. Its content, the elements that compose its inner system, cannot be established in an abstract manner, but with the attention placed on the circumstances of the cases analyzed, and through *concretization* (Hesselink, 2004, p. 622). Being an open rule, what really matters is the way in which good faith is applied by case analysts, such as judges, but also by international arbitrators. Its meaning is fundamentally best shown by the way in which it operates.

a) The general process of rendering objective good faith operational

We could argue, based on the above, that, on the one hand, objective good faith has been historically a mouthpiece through which new legal rules are created, which would be illustrated by the example of *laesio enormis*, or *culpa in contrahendo*.

The process through which this has taken place has been traditionally known as *concretization*. In the German legal tradition, this method has consisted in the application of the law in general, and of general clauses like good faith in particular, as rational and objective (and hence predictable) as possible. The result has been that there is little to no discretion for the deciding judge to use his subjective criterion when applying the general clause⁶. The method consists in distinguishing functions and developing groups of cases (*Fallgruppen*) in which good faith has previously been applied. The result: a system of sometimes quite specific duties, prohibitions, sub rules, and doctrines, which are all part of the inner system of good faith (Hesselink, 2004, p. 624).

The particular use of this method in Germany has provided for four distinct functions of objective good faith, which are: supplementation of duties; limitation of rights; correction (*Wegfall der Geschäftsgrundlagen*); and interpretation⁷. Concerning the groups of cases, these gather various stages of the contractual process, such as formation; interpretation; content; and performance. From these, the result has been a variety of well-established legal forms defining terms and conditions under which the general concept of good faith is to be used.

⁶ If there is a more specific legal institution than the good faith open norm when tackling opportunistic behavior, the latter takes precedence over the former.

⁷ All four of them derived from the general provision of good faith contained in 242 BGB, and a fourth one specifically from 157 BGB.

Adding the above mentioned elements that provide objective good faith with internal structure, among others, it is worth mentioning *culpa in contrahendo* (Kessler & Fine, 1964); contract with protective effects for a third party (*Vertrag mit Schutzwirkungen zugunsten Dritten*); liability for breach of trust; adaptation of the contract to changed circumstances; side obligations of a contract; principle of trust in formation, interpretation, and gap filling of legal transactions; abuse of rights; and the duty to inform (Schäfer & Can Aksoy, 2015, p. 3).

Given the open character in which the good faith norm is usually presented –as in the case of German and Colombian law⁸, as well as in the compilations such as the Principles- it has been discussed how this can become problematic. On the one hand, it may give wide discretion to judges, which may be used to import ideology into contract law, or to promote personal opinions of their own. On the other hand, it may also foster judicial activism, which is particularly problematic in civil law countries (Annull, 2013). Judges may develop the law rather proactively, blurring the lines between branches of public power. Furthermore, the open norm can be used to redistribute wealth from the rich to the poor using a deep pocket approach (Schäfer & Can Aksoy, 2015, p. 2).

Notwithstanding this risk, it can also be asserted that one particular function of the inner system that has been structured within the shadow of the principle of good faith is to diminish the risk of arbitrary interference by the judiciary. Furthermore, Schäfer and Aksoy (2015, p. 3) argue that there is a well-founded agreement among legal scholars on the specific conditions that are to be observed for the application of any of the legal subcategories that derive from the good faith principle by the judiciary⁹.

Regarding the applications that judges make of good faith, taking into consideration the case groups identified by legal scholars, and its different functions, it has been argued, that judges civil law countries have felt traditionally uncomfortable with their role as creators of legal rules, and not merely applicators of them. However, when they do produce decisions based on good faith, this general clause is used as a cover for such new creations. Judges, in this sense, do create new rules, in spite their uneasiness. If the role of the judge as a creator of new rules is fully recognized, there is no need for a general good faith clause in a code or restatement of rules. In turn, where there is such doubt regarding the function of judges, good faith would have a place as a formula empowering judges and arbitrators to create new rules. And in this sense, good faith is a kind of cover for the judges for the creation of new rules – when it is so demanded from them (Hesselink, 2004, p. 645).

It could be argued that the situation in international trade is precisely one in which, in some cases, international arbitrators are expected to contribute to the transnational rule of law by creating a rule that supplements, for instance, the will of the parties expressed initially in the contract. What is specially characteristic of the Principles is that they rely heavily on the notion of the *Creeping Codification* of transnational commercial law: “a non-exhaustive, open

⁸ In article 1603 of the Colombian Civil Code, objective good faith is mentioned also as a –particularly- broad concept, being presented without any explanation of its meaning. According to it, a contract must be executed in good faith. In line with its discussed capacity to create, to modify and to extinguish obligations, parties are not only subject to the wording of the contract, but also “to all the things that emanate precisely of the nature of the obligation, or that by law pertain to it.”

⁹ Candidly, these authors mention that, if the good faith principle is potentially a monster, it has been domesticated as a farm animal.

list of principles and rules of the New Lex Mercatoria that is constantly updated but never completed (Berger, 2019; Trans-Lex, 2019).” Its most striking and noticeable feature is its *dynamism*. And operating on this particular premise, such constant, never-ending effort clearly must be heavily based on what international arbitration tribunals produce when adjudicating international trade disputes. Regarding the norm, the norm of good faith intentionally made open, it is important to observe what international arbitrators have to say –either by applying the good faith principle as a last resort, or by tackling innovative forms of contract opportunism by producing a new legal subcategory, or anchor, logically derived from good faith. Such should aid in the process of enrichment of the inner system that is derived from objective good faith at an international level with the distinct objective of providing for tools that curtail opportunistic behavior.

So, with the “raw material” that would be the open rule of objective good faith within the Principles, international arbitrators should be able to contribute to the transnational rule of law applicable to commercial disputes. One question that appears to be relevant at this point is whether arbitration, at an international level, is structurally capable of creating legal rules – as it would be the case when, based on the open norm of good faith, they would do in order to tackle new forms of opportunistic behavior at an international level. If the question is given an affirmative answer, good faith would be recognized as an important element for the process of concretization of new legal institutions curtailing opportunistic behavior in a constant effort to contribute to transnational commercial law.

b) Transnational trade, international arbitration and the open rule of objective good faith

It remains arguable if all kinds of arbitration can be expected to produce legal rules, taking into consideration some aspects of its current practice.¹⁰ However, as Weidemaier (2010, p. 1899) argues, “*although not every system of arbitration generates precedents, some clearly do.*” That they do can be understood as the situation around transnational commercial law cases.¹¹ And if it is expected from international commercial arbitration to –sometimes– produce some new rules, an open norm of good faith habilitates this process, for the specific purpose of tackling new forms of opportunistic behavior.

Asymmetry of information is a characteristic feature of transnational trade. In this sense, facing constantly innovative ways in which one contract party can behave opportunistically toward the other one, international arbitrators experience incentives to meet the demand for new subcategories of the inner system of good faith –for those cases that are not yet covered by the already existing anchors tackling opportunistic behavior.¹² In fact, producing obscure decisions with no visible rule to lessen uncertainty in future cases, particularly those related

¹⁰ For important manifestations of this debate see: Carbonneau (2002), Cooter and Rubinfeld (1989), Landes & Posner (1979), Brunet (1987), Edwards (1986), Benson (1990, 1999, 2000), Caplan & Stringham (2008a), and Stringham (1999).

¹¹ Such view is further supported by Bjorklund (2008), Benson (1989, 1990a, 1999, 2000) and Cheng (2006).

¹² See Section Good faith as anti-opportunism in contract law.

to opportunistic behavior, can result in lower demand for the services of a specific arbitrator – or a specific arbitration center. In short, it can be argued that international arbitrators in transnational commercial disputes are interested in meeting the demand for clear rules, especially for those curtailing opportunistic behavior for future cases.

Based heavily on international arbitration case law, the Creeping Codification that is represented by the Principles should count on the raw resource that is an objective good faith clause as an open rule. After all, international arbitration, as it has been discussed in the literature, does contribute to the transnational commercial law as codified in the various manifestations of the NLM (Benson, 1989, p. 658; Drahozal, 2009, p. 1036).¹³ In spite of the risks of judicial activism that could be enhanced at an international level by international arbitrators, it could be argued the benefits of such a clause outweigh those. It is an appropriate strategy to secure to a reasonable degree the production of new specific legal rules that could potentially aid in the enhancing of legal certainty at an international level. After all, one important source of rules and principles composing the NLM are those which are extrapolated from individual cases in the context of international commercial arbitration (Berger, 2019, para. 73).

One interesting illustration comes from international arbitration practice. On the case known as *Westland Helicopters*, member states of an international organization were held subsidiary responsible for certain debts, which were initially incurred by the organization itself, the Arab Organization for Industrialization (henceforth, AOI). The AOI later on defaulted. The reason underlying the ruling was that such member states had not excluded their responsibility on the states of the organization. The core of the reasoning of the arbitrators was based on the principle of good faith –once again reinforcing the insight regarding the operational meaning of it. At the time, the appointed arbitrators were confronted with the inquiry of the extent to which there is a subsidiary responsibility of member states in an international organization such as the AOI. If the claimant heavily discounts the possibility that the organization can live up to its promises, which raised legitimate expectations at some point, can he count on the possibility to sue the member states composing that organization? This question was given an affirmative answer. The arbitrators presented the argument that, given that there was no express exclusion of subsidiary responsibility in the statutes of the organization, the parties contracting with it could legitimately expect such *subsidiary responsibility*. Parties can, in these kinds of situation, rely on the principle of objective good faith as a clause that compels parties to refrain from opportunistic behavior. Indeed, the arbitrators argued that such rule of *subsidiary responsibility* flows from the general clause of good faith (International Chamber of Commerce, 1994, p. 613).

The merit of this particular case rests on the fact that the general clause of good faith can be summoned in a relatively flexible manner in order to justify the appointed arbitrator's quest for further developing international law, where there are legal gaps in it –and the strict

¹³ For introductory remarks on the economic analysis of arbitration, and its capacity to create legal rules, see Caplan (1997) and Caplan and Stringham (2008b).

application of the binding contract would lead to absurd results. Nowadays, this particularly timid process has resulted in the concretization of the subsidiary responsibility rule of an international organization, which is regulated in art. 62 of the International Law Commission's Articles on the Responsibility of International Organizations (Kolb, 2017, pp. 193–194).

In the particular case of the Principles, an interesting example comes from Principle No. I.2.1, relating to the *standard of reasonableness* (Trans-Lex, 2020). According to the wording of the legal provision, the parties always have to act according to what is reasonable in view of the particular nature of their transaction and the circumstances involved, in particular the economic interests and expectations of the parties. Clearly, the provision is making an indirect reference to those situations in which, opportunism can be present, whenever discretion is being exercised in order to recapture forgone opportunities, against the legitimately formed expectations of one of the parties.¹⁴ The provision, in this sense, is based on the general, open clause of objective good faith as enunciated in Rule No. I.1.1 of the Principles.

Evidence of the logical deduction linking both norms is presented by an international commercial arbitration decision. In the context of a contract of land and sea transportation between an English enterprise and a French transportation company, the latter affirmed a raise in the price, because the transported pieces were more than the ones originally intended, and more voluminous. The English enterprise denied such petition. It argued that, indeed, the parties had agreed on eventual price adjustments, but only to those related to changes in sea freight tariffs. The arbitrator produced the award in favor of the French transportation company. It argued, that the conventions have to be interpreted in good faith, meaning by this, in the particular case, that each party has an obligation to display a behavior toward the other party which is not supposed to harm the other one. This implies that renegotiations are usual in international economic affairs in case of abrupt changes in conditions leading to disequilibrium. Behaving unreasonably in this case would have been tantamount to behaving in bad faith, inasmuch as a strict application of the contract terms – which would initially block the renegotiation of the price based on the French claims- would unjustifiably harm one of the parties (ICC, 1975, p. 990).

Conclusions

Good faith, as included in the wording of the Principles –but also in civil law codifications– means refraining from behaving opportunistically in a contract relationship. The inner system that is found within the open rule of good faith has been traditionally built through concretization advanced by dispute resolution mechanism of an adjudicative kind –such as judges and arbitrators adjudicating contract disputes.

That international commercial arbitration is capable of creating rules is, of course, a controversial subject. However controversial as this issue might be, in the international trade context, it is usually argued that arbitrators do create rules, and thus contribute to the body of

¹⁴ See section 0.

transnational commercial legal rules that is the NLM. Furthermore, the fact that the duty to perform in good faith is included as a norm with such a degree of openness in the Principles should be evidence enough of the potential for opportunistic behavior in international contracts. That is open can be explained by the economic rationale that there is a constant demand for those new anchors that curtail opportunism –in a way in which the general clause of good faith, or its already concretized rules, cannot. The wording of the principle must be open-ended, the argument would follow, so international appointed arbitrators can meet the demand of newly created rules –potentially becoming anchors in the future- that curtail opportunism at an international level.

Lack of an open norm of good faith could stale this process. Such is the meaning of good faith, which calls constantly for concretization by both judges and arbitrators adjudicating cases with international elements, and relying on the Principles. This, of course should be the object of further research. This paper, however, is concerned in setting the first rock in such a rocky path.

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