14

Good Faith as Contract's Core Value

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The common law of contract has long recognized a duty of good faith in performance.[1] This chapter argues that this duty is contract's core value—that good faith *constitutes* the distinct form of legal obligation that contracts establish. An initial section introduces the duty of good faith in performance through a series of doctrinal examples. Subsequent sections examine the metes and bounds of good faith and elaborate a theory of this duty. The theory explains that the duty of good faith in performance neither adds to the obligations that contracts impose nor recasts the substantive terms of actual contracts to fit any ideal. Instead, good faith is an attitude that contracting parties might take to the agreements that they have in actual fact made. When contracting parties approach their agreements in good faith, they at once respect freedom of contract and establish their contractual relations as sites of intrinsically valuable reciprocal recognition. Good faith thus constitutes contracts as what I have elsewhere called *collaborations*.[2]

I. Good Faith in Contract Doctrine

In the United States, the Uniform Commercial Code imposes a mandatory duty of good faith in performance on "every contract" within its scope.[3] The *Restatement (Second) of Contracts* similarly says that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[4] Moreover, the two authorities elaborate good faith in similar terms. The U.C.C. thus adds that "good faith" means "honesty in fact and the observance of reasonable commercial standards of fair dealing."[5] The comments to the Restatement explain that good faith "excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness."[6]

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[1] A seminal authority is Lord Mansfield's opinion in *Boone v. Eyre*, (1777) 126 Eng. Rep. 160 (K.B.); 1 H. Bl. 273. An early case imposing this duty in an American Jurisdiction is *Kirke La Shelle Co. v. Paul Armstrong Co.*, 188 N.E. 163, 167 (N.Y. 1933).

[2] Daniel Markovits, *Contract and Collaboration*, 113 Yale L.J. 1417 (2004).

[3] Uniform Commercial Code § 1-304 (2003) [hereinafter U.C.C.]

[4] Restatement (Second) of Contracts § 205 cmt. [a] (1981) [hereinafter Restatement].

[5] U.C.C. §§ 1-201, 2-103.

[6] Restatement § 205 cmt. [a].

Philosophical Foundations of Contract Law. Gregory Klass, George Letsas, and Prince Saprai.

While the Restatement sensibly takes the position that a "complete catalogue of types of bad faith is impossible," it nevertheless provides representative examples. These include: "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance."[7] The comments add that good faith

> is violated by dishonest conduct [in enforcing contract rights] such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. [Good faith is also violated by] dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without a legitimate commercial reason. [Good faith is also violated by] harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract.[8]

Good faith forbids parties from hiding behind indefinite contract terms, either by construing them in an excessively self-serving light or by claiming that the indefiniteness renders the contracts containing them void, *tout court*. Instead, where a contract leaves the particulars of performance to be specified by one of the parties, that party is constrained to make the specification in good faith,[9] which, as the comments to the U.C.C. say, entails that "the range of permissible variation is limited by what is commercially reasonable."[10] In the context of sales contracts that measure quantity by the output of the seller or the requirements of the buyer, good faith requires that the quantity a party orders or delivers not be unreasonably disproportionate to the legitimate expectations of the counterparty.[11] Contracts for exclusive dealings in some class of goods similarly require parties to use their best or at least reasonable efforts to supply or promote the goods in question.[12]

A comparable regime governs contracts in which terms essential to operating the contracts as circumstances have developed are not just left indefinite but are not included at all.[13] Where the parties have failed to make adequate arrangements for some contingency *ex ante*, they must employ good faith in making arrangements *ex post*. For example, termination is governed by good faith,[14] at least where the contract does not establish any specific regime. A party seeking to terminate may not do so before the nonterminating party has had "reasonable notification,"[15] which is to say a "reasonable time to seek a substitute arrangement."[16]

[7] Restatement § 205 cmt. [d]. [8] Restatement § 205 cmt. [e]. [9] U.C.C. § 2-311(1).
[10] U.C.C. § 2-311 cmt. 1. [11] U.C.C. § 2-306(1).
[12] *See* U.C.C. § 2-306(2); *Wood v. Lucy, Lady Duff-Gordon*, 118 N.E. 214 (N.Y. 1917).
[13] A similar principle may be found in English law, although not necessarily under the header "good faith." An example is the rule that "[w]here in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect." *Mackay v. Dick*, (1881) 6 App. Cas. 251 (H.L.) (Blackburn, J.).
[14] *See* U.C.C. § 2-309 cmt. 8. [15] U.C.C. § 2-309 cmt. 5. [16] U.C.C. § 2-309 cmt. 8.

The warranties concerning title that a seller provides her buyer are also governed by good faith. In particular, where a contract does not specify otherwise, a seller warrants that her title is good and its transfer is rightful, and that the buyer will not be unreasonably exposed to litigation based on third parties' colorable claims or interests in the goods.[17] Similarly, good faith requires a seller to disclose known material but hidden defects in goods sold.[18] The disclosure may be waived by a disclaimer that asserts that there may be hidden defects, but this of course puts the buyer on notice that goods may not be as they appear. And although contracting parties generally can, "if they consciously desire, make their own bargain as they wish,"[19] good faith precludes a party from using one clause to undo a promise made in another, at least in circumstances in which honoring the undoing cannot be understood except as implementing the manipulative term of a bait and switch. This principle applies with especial force to preclude sellers' efforts to disclaim warranties that their selling methods are designed to convey the impression of having given. The comments to one of the U.C.C. sections on warranties thus observe that "a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming 'all warranties, express or implied' cannot reduce the seller's obligation for the description and therefore cannot be given literal effect."[20] Rather, "in determining what [the parties] have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation."[21]

In all these ways, the duty of good faith in performance regulates advantage taking within the contract relation. Unsurprisingly, therefore, good faith becomes particularly important where structural circumstances make it impracticable or even impossible for the parties to regulate such advantage taking directly and expressly, because prior agreements cannot effectively reach them.

Thus, although contracting parties generally remain free to renegotiate or rescind their contracts, good faith precludes one party from employing this freedom strategically, to exploit vulnerabilities of the other that are themselves created by (indeed creatures of) the contracts to be renegotiated.

For example, it is bad faith for an employer to discharge a sales employee who is paid on commission after the employee has obtained an extraordinarily large order but before completion of all the formalities required to make the commission come due.[22] Similarly, it would be bad faith for an employer to fire an employee just before the employee meets a performance quota that triggers a substantial bonus. In each case, the employee has expended effort that the employment contract contemplated and indeed was designed to induce and, by rendering this effort a sunk cost, eliminated her power to bargain for a share of the return to the effort. In refusing to pay the commission or the bonus, the employer has deprived the employee of the share of the return to her effort that the contract had allocated to her *ex ante* and exploited the employee's weakened bargaining position *ex post*. This is bad faith.[23]

[17] U.C.C. § 2-312(1) & cmt. 1. [18] U.C.C. § 2-314 cmt. 4. [19] U.C.C. § 2-313 cmt. 6.
[20] U.C.C. § 2-313 cmt. 6. [21] U.C.C. § 2-313 cmt. 6.
[22] *See Fortune v. National Cash Register*, 364 N.E.2d 1251 (Mass. 1971).
[23] Other cases display a similar, and similarly clear, pattern, in different fact settings. Thus, it is bad faith for a buyer who has contracted to purchase a specific asset from a middleman subsequently

Insurance contracts present similar patterns. Typically, an insurer assumes duties both to pay damage awards or settlements secured against the insured by injured third persons in connection with covered events, up to some limit, and to defend the insured against claims for such damages. This makes it bad faith for the insured to exploit the insurer's position by insisting on accepting unreasonably large settlement offers, and refusing to cooperate in any further defense, on the ground that this costs her nothing and saves her the burden of the lawsuit. And, much more practically important, it is bad faith for the insurer to reject reasonable settlement offers near the policy limit, on the ground that it bears none of the litigation risk associated with rejecting the offers.[24] In each case, one party exploits a strategic vulnerability of the other that arises inside the insurance contract (and indeed is caused by the contract) to secure its private advantage. Once again, this is bad faith.

Finally, good faith applies to create effectively mandatory duties in circumstances in which the parties' contractual relations have broken down in ways such that no prior agreement could reliably govern conduct. The most common such circumstances involve a party's response to his counterparty's breach, and thus in particular concern the party's efforts to recover damages. The parties cannot contract *ex ante* for the case in which a promisor denies her contractual obligations entirely, because this denial would cover any agreement that they had made for such a case. The promisor's denial of the contract does not, however, disentangle the parties from each other's affairs. The disappointed promisee will continue to insist on her contractual rights and to take steps to vindicate these rights. Insofar as the steps that she takes might impose costs on her promisor, the law must regulate her conduct (as the parties' agreement cannot). A mandatory duty of good faith figures prominently in this regulation.

For example, although a seller whose buyer has breached may, in appropriate circumstances, avoid the burden and expense of proving up market damages and instead resell the goods and recover damages based on the contract-resale price difference,[25] the resale must be made in good faith.[26] Relatedly, although sellers whose buyers breach may recover consequential damages, their recovery is limited according to their duty to make a good faith effort to minimize (including by resale) the consequential damages suffered as a result of the breach.[27] Analogous duties of good faith apply to buyers with respect to cover when their sellers breach[28] and to buyer's duties to mitigate (including by purchasing cover) their consequential damages from breach.[29]

These examples may be multiplied. And they all reaffirm the general lesson drawn earlier. The duty of good faith polices advantage taking within the contract relation. It seeks to prevent the frame of the contract relation—the fact that the parties to this relation rely on

to buy this asset directly from the middleman's supplier in order to save having to pay his profit. To do so would be to exploit the vulnerability to which the contract has exposed the middleman—the revelation of the asset to the buyer—in order to deprive the middleman of the very gain that the contract was designed to secure him. *See*, *e.g.*, *Patterson v. Meyerhofer*, 97 N.E. 472 (N.Y. 1912). Similarly, it is bad faith for a financing-dependent buyer to fail to make adequate efforts to seek financing. *See*, *e.g.*, *Fry v. George Elkins Co.*, 327 P.2d 905 (Cal. App. 2d 1958); *Goldberg v. Charlie's Chevrolet, Inc.*, 672 S.W.2d 177 (Mont. Ct. App. 1984).

[24] *See*, *e.g.*, *Comunale v. Traders & General Ins. Co.*, 328 P.2d 198 (Cal. 1958) (en banc).

[25] U.C.C. § 2-706. [26] U.C.C. § 2-706(1). [27] *See* U.C.C. § 2-708 & cmt. 6 thereto.

[28] *See* U.C.C. § 2-712(1) & cmt. 4. [29] *See* U.C.C. § 2-715 & cmt. 2.

each others' expressed intentions—from becoming itself an opportunity for manipulation or exploitation. Good faith steps in to *require* contracting parties to respect each other's contractual intentions even where they, preferring manipulation, are disinclined to do so.

II. The Metes and Bounds of Good Faith

The examples all share the general sentiment that it is bad faith for one party to use the fact of the contract to exploit the other going forward. Thus it is said that good faith precludes a party from using its inevitable room to maneuver within the contract "to recapture opportunities forgone upon contracting."[30] Bad faith in performance, that is, "consists of an exercise of discretion in performance to recapture opportunities forgone at formation."[31] Most importantly, a party cannot use the very fact that after negotiations had concluded in an agreement, his counterparty took steps (pursuant to that agreement) that rendered her more vulnerable than she was in the negotiations, now to renegotiate aspects of the agreement on more favorable terms. In the words of a prominent early American opinion, "In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing."[32]

This formulation provides an important warning against an attractive error. It is tempting to think that the duty of good faith in performance *adds* to the content of contractual obligation—to this obligation's metes and bounds—concretely and in the context of particular contracts. Courts and commentators both occasionally succumb to temptation on this point. They treat good faith as what Allan Farnsworth and then-Judge Scalia, reciprocally quoting each other, have called "implying terms in the agreement."[33] Some even go so far as understanding the duty of good faith in performance to import one or another conception of what Todd Rakoff has called "exchange justice" into contract law.[34] On this view, now expressed in Daniel Friedmann's words, good faith imposes "restraints on self-interest in deference to a much heavier interest of another party."[35] Jack Beatson has offered a similar account of certain limits on advantage taking within contracts that have made their way into English law.[36] Even legislatures have gotten into this business, as in the

[30] Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, 373 (1980).

[31] Burton, *Breach of Contract*, at 387.

[32] *Kirke La Shelle Co. v. Paul Armstrong Co.*, 188 N.E. 163, 167 (N.Y. 1933). The case involved a silent-film era agreement to share "motion picture" rights to a play and the question whether rights to make a "talkie" based on the play were within the scope of the agreement. The court held that they were not. It has seemed to many that this is a mistake on the facts. *See L. C. Page & Co. v. Fox Film Corp.*, 83 F.2d 196, 199 (2d Cir. 1936) (words "motion picture" in pre-"talkie" contract held to include "talkies"); *see also Bartsch v. Metro-Goldwyn-Mayer, Inc.*, 391 F.2d 150 (2d Cir. 1968), *cert. denied*, 393 U.S. 826 (1968).

[33] *Tymshare Inv. v. Covell*, 727 F.2d 1145, 1152 (D.C. Cir. 1984); E. Allan Farnsworth, *Good Faith in Contract Performance, in* Good Faith and Fault in Contract Law 153, 161 (Jack Beatson & Daniel Friedmann eds., 1995).

[34] Todd Rakoff, *The Implied Terms of Contracts: Of "Default Rules" and "Situation-Sense," in* Good Faith and Fault in Contract Law 191, 195 (Jack Beatson & Daniel Friedmann eds., 1995).

[35] Daniel Friedmann, *Good Faith and Remedies for Breach of Contract, in* Good Faith and Fault in Contract Law 399, 400 (Jack Beatson & Daniel Friedmann eds., 1995).

[36] Jack Beatson, *Public Law Influences in Contract Law, in* Good Faith and Fault in Contract Law 263, 288 (Jack Beatson & Daniel Friedmann eds., 1995).

English Unfair Contract Terms Act, which (in Hugh Beale's words) has the "substantive content" that some clauses "cause such an imbalance that they should always be treated as being contrary to good faith and therefore unfair."[37] This approach adopts a substantive regime very similar to that which jurisdictions in the United States have imposed through substantive unconscionability; but it imposes this regime under the heading "good faith."

Such approaches possess a natural appeal. To understand good faith as inserting an additional, mandatory obligation into every contract would be to be able to use the duty to decide (close) cases. Being practical, lawyers and judges naturally seek guidance and assistance in resolving concrete disputes. Good faith understood as a distinctive additional contract term promises to provide both.

This promise is unlikely to be fulfilled, however.

To be sure, it is possible to fix the inner and outer bounds of good faith. On the one hand, it is commonly and rightly observed that "conduct that might not rise to the level of fraud may nonetheless violate the duty of good faith in dealing with one's contractual partners."[38] Good faith must require more of the parties than just that they abjure fraud, because good faith refers to rights established by a completed bargain rather than only to rights against being misused in bargaining.

On the other hand, it is equally familiar that good faith requires less than fiduciary loyalty and devotion.[39] A fiduciary, as it is sometimes said, is "required to treat his principal as if the principal were he."[40] In fact, a fiduciary must treat his principal more carefully still: there is any number of risks that a person might (even reasonably) take on his own account that he may not, acting as fiduciary, take on his principal's. Good faith, by contrast, does not require contracting parties to display substantive other-regard or altruism, preferring their partners' interests over their own, or even weighting the two interests equally, within their contracts. Good faith, in the words of one prominent opinion, "does not mean that a party vested with a clear right is obligated to exercise that right to its own detriment for the purpose of benefiting another party to the contract."[41] Another prominent American court draws the contrast between good faith and fiduciary loyalty more directly still. "'[G]ood faith,'" the court observes, "does not envision loyalty to the contractual counterparty, but rather faithfulness to the scope, purpose, and terms of the parties' contract."[42] English law takes a similar approach. As Jack Beatson has pointed out, "[o]ne of the hallmarks of English common law is that it does not have a doctrine of abuse of rights: if one has a right to do an act then, one can, in general, do it for whatever reason one wishes."[43] This has the consequence that "[e]xcept where the contracting parties are also in a fiduciary relationship, self-interest is

[37] Hugh Beale, *Legislative Control of Fairness: The Directive on Unfair Terms in Consumer Contracts, in* Good Faith and Fault in Contract Law 231, 245 (Jack Beatson & Daniel Friedmann eds., 1995). Beale points out that the statute "does not require that the significant imbalance be caused by the absence of good faith" (n. 91).

[38] *Mkt. St. Assocs. Ltd. P'ship v. Frey*, 941 F.2d 588, 594–5 (7th Cir. 1991).

[39] *But see Parev Prods. Co. v. I. Rokeach & Sons, Inc.*, 124 F.2d 147 (2d Cir. 1941), which comes close to taking a fiduciary duty view, seeking "the really equitable solution" as opposed to "a limited rule of good faith" (at 150).

[40] *Mkt. St. Assocs.*, 941 F.2d at 593.

[41] *Rio Algom Corp. v. Jimco Ltd.*, 618 P.2d 497, 505 (Utah 1980).

[42] *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member*, L.L.C., 50 A.3d 434, 440–41(Del. Ch. 2012) *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013). I owe this reference to Andrew Gold.

[43] Beatson, *Public Law Influences in Contract Law*, at 266–7.

permissible, and indeed is the norm in the exercise of contractual rights."[44] Mere self-interest therefore cannot be bad faith.

Judge Richard Posner puts this point more colorfully, observing in *Market Street Associates Limited Partnership v. Frey*, that "[t]he contractual duty of good faith is thus not some newfangled bit of welfare-state paternalism or the sediment of an altruistic strain in contract law."[45] Similarly, "even after you have signed a contract, you are not obliged to become an altruist toward the other party."[46] Nor does good faith require contracting parties to adopt even an attitude of substantive impartiality between their contractual interests and the interests of their contracting partners. The duty of good faith in performance applies, after all, to every contract, including to contracts among sophisticated parties who can take good care of their own interests. The law does not seek, "in the name of good faith, to make every contract signatory his brother's keeper."[47] Good faith is not a principle of substantive fairness even just in the face of new contingencies that arise within the contract relation. Good faith thus leaves the parties free to be self-interested within their contracts—as self-interested as they were without them, subject only to honoring the terms of their agreements.

The inner and outer bounds of good faith are thus easy to discern. But it is not possible to say in general precisely where good faith falls in between these inner and outer bounds, at least not in a way that mechanically decides cases. In any concrete case, party conduct will slide seamlessly from clear bad faith, which undermines the contract, to clear good faith, which embraces the contract's purposes. The thought that good faith protects the reasonable contractual expectations of the parties cannot insert a seam.[48] The root reason why the idea that good faith in performance "protects the reasonable contractual expectations of the parties against *ex post* advantage taking" cannot fix the boundaries of good faith in a fashion that can decide close cases is that good faith is required precisely because the contractual intentions of the parties, and hence also their reasonable expectations, are not complete or clear. An account that understands good faith as a *rule of decision*, thus commits a circle: it supposes

[44] Beatson, *Public Law Influences in Contract Law*, at 267.

[45] *Mkt. St. Assocs. Ltd. P'ship v. Frey*, 941 F.2d 588, 595 (7th Cir. 1991).

[46] *Mkt. St. Assocs. Ltd. P'ship v. Frey*, at 594. [47] *Mkt. St. Assocs. Ltd. P'ship v. Frey*, at 593.

[48] A classic example of the problem appears in *E. Airlines, Inc. v. Gulf Oil Co.*, 415 F. Supp. 429 (S.D. Fla. 1975).

Eastern Airlines had contracted with Gulf Oil Corporation for Gulf to supply Eastern's requirements of jet fuel over a several-year period. The contract fixed the purchase price by reference to a price indicator called "West Texas Sour" reported in a trade publication called Platts Oilgram Service-Crude Oil Supplement. In the middle of the contract period, the 1973 O.P.E.C. oil embargo surprised world oil and fuel markets, causing prices to rise unexpectedly. However, and layering a second surprise on top of this first, the West Texas Sour price indicator did not reflect the hike in prices. (This was due to intricacies involving price controls implemented following the crisis.) The contract price therefore came to depart dramatically from the market price, and litigation ensued.

This raised the question how much fuel Eastern might demand consistent with good faith. In particular, Eastern's airplanes had taken on more fuel at certain airports than required to reach their next destinations, in order to refuel less frequently and to avoid refueling at certain other airports entirely. This practice, known as fuel-freighting, had allowed Eastern to avoid the inefficiencies associated with frequent refueling and with refueling at awkward locations. On the other hand, by increasing the flying weight of its airplanes, fuel-freighting had also increased Eastern's total fuel consumption. By lowering Eastern's fuel prices (through the anomalous West Texas Sour indicator), the contract with Gulf had shifted the balance of these costs in a fashion that increased the amount of fuel-freighting that was what it purports to determine, that is, how much the terms of the contract allow each side to exploit subsequent developments to its unilateral advantage.

Good faith thus provides little help in drawing a line between permissible and impermissible conduct in between the outer and inner bounds (fraud on the one hand, and fiduciary loyalty on the other) just set out. Nor could it be expected to. Indeed, the additional duty conception of good faith does not simply initiate a fruitless quest but furthermore rests on a fundamental mistake. Good faith simply does not determine the *content* of contract obligation, and certainly not at the margins of performance (by adding an incremental duty or right to what the contract would have required in its absence). The Official Comment to U.C.C. §1-304 makes this plain:

> This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.[49]

The U.C.C.'s formulation invites theoretical reflection. The task of legal theory is not simply to help decide (close) cases. Legal theory also seeks to illuminate the character of legal relations. It seeks, speaking a little loosely, to reveal the meaning of the law. An account of good faith might therefore have great theoretical value even if it provides only

optimal for Eastern. Gulf claimed that Eastern's fuel-freighting violated its obligation to set its requirements reasonably and in good faith.

As in general, the inner and outer bounds of good faith might be confidently identified in this case also. Thus it would have been clear bad faith, for example, for Eastern to use the contract to support fuel-arbitrage, buying at below market prices from Gulf and selling to its competitors at market prices. The contract, after all, unambiguously concerned Eastern's jet-fuel requirements as an *airline*, that is, for use in its airplanes, and not as a jet-fuel *dealer*. At the other extreme, it would have been clear good faith for Eastern to fuel and fly in precisely the patterns that it would have adopted, pursuant to the contract, had the contract and market prices not diverged. Eastern had no affirmative duty, under the contract, to adjust its fuels requirements downward to serve Gulf Oil's interests.

But these extremes mark out an immense middle ground, and assessing the extremes leaves it unclear where in this middle ground the line between good and bad faith lies.

Would it have been bad faith for Eastern to increase its requirements in connection with acquiring a competitor, where the acquisition was motivated exclusively by Eastern's access to cheaper fuel? Presumably so, since such an acquisition (with its exclusive motivation) looks like fuel arbitrage by other means. But if this is so, then surely the same argument applies to render it bad faith for Eastern to add airplanes or even just flights to its operations, at least where the growth is driven by cheap fuel. (The airplanes and routes, after all, will be won—and sometimes even literally bought—from Eastern's competitors; and it cannot matter to Eastern's good faith whether its expansion occurs by buying the competitor's stock or by acquiring its business assets.) And now it is only a small, and seemingly inexorable, step to calling it bad faith for Eastern to increase its fuel requirements in any way (or indeed to fail to decrease them in any way) on account of its advantageous price. This conclusion, however, cannot be right, as one of the points of a requirements contract—one of the benefits that the contract is intended to confer on a buyer and hence something that it must be good faith for her to insist on—is surely to allow a buyer to improve its business position (and hence among other things to grow) on account of having a reliable supply of inputs. The examples slide seamlessly from clear bad faith, at odds with the contract's purposes, to clear good faith, which embraces these purposes.

[49] U.C.C. § 1-304 cmt. [1].

limited assistance in deciding cases. An understanding of good faith thus does not so much help to decide cases as to understand what has been decided.

Good faith thus characterizes contract obligation's *form* and identifies an *attitude* towards contractual obligations: good faith supports the parties' contractual settlement, working to "effectuate the intentions of the parties, or to protect their reasonable expectations."[50] It is thus, fundamentally, an attitude of respect for the contract relation, and the measure of good faith is the contract itself. Good faith thereby establishes the character of the contract relation. It involves a distinctively contractual form of recognition and respect and fixes the character of contractual collaboration. A nonconclusory account of good faith explains, directly and without reference to other theory-laden terms, how contracting parties must balance self- and other-regard as they interpret, fill out, and implement their contractual arrangements.

III. Good Faith, Freedom of Contract, and Contractual Solidarity

Good faith requires contracting parties to vindicate reasonable contractual expectations but cannot be called on to fix the content of the expectations in whose terms it is defined. The measure of each party's good faith is the agreed purpose memorialized in the contract, which is to say the legitimate contractual expectation of the other. Good faith so understood is not a principle of substantive fairness in the face of new contingencies. The parties thus remain free to be self-interested within the contract—as self-interested as they were without it, subject only to the demand that they honor the terms of their agreement. A party may not use unanticipated contingencies to deprive his counterparty of a benefit that the contract allocated to her. But the parties equally need not sacrifice anything in the face of new contingencies that the contract does not require, nor need they assist the other parties in gaining from contingencies.

This feature of good faith—that it does not establish affirmative duties of other-regard so much as articulate respect among parties who remain at arm's length—will turn out to be essential to good faith's character, and indeed to the character of the contract relation generally.

The arms-length nature of good faith is itself rendered concrete in doctrine, for example, in the expectation remedy and the associated practice of "efficient breach."[51] The expectation remedy establishes a default that promisors insure their promisees against breach by guaranteeing the promisees' value of performance—through it, the law vindicates promisees' contractual expectations. At the same time, the remedy allows a promisor who confronts an opportunity to increase overall surplus by diverting the promised performance to a higher-valuing third party self-interestedly to appropriate the gains from dealing with the third party for herself.

[50] Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 371 (1980). For cases, *see, e.g.*, *Sessions, Inc. v. Morton*, 491 F.2d 854, 857 (9th Cir. 1974); *Ryder Truck Rental, Inc. v. Cent. Packing Co.*, 341 F.2d 321, 323–4 (10th Cir. 1965); *Perkins v. Standard Oil Co.*, 383 P.2d 107, 111–12 (Or. 1963) (en banc).

[51] The account of the expectation remedy that follows receives a more elaborate development in Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97

As long as she transfers to the promisee an amount equal to the expectation remedy, a promisor who commits such an "efficient breach" surely displays no bad faith. The transfer vindicates the promisee's reasonable contractual expectations. After all, the parties, bargaining in the shadow of the remedy, will have reduced the contract price (and increased the promisee's contractual expectations) in light of the promisor's right to retain the gains from the "efficient breach."[52] The parties' contractual intentions will have contemplated that the promisor retains such gains *ex post*, and she will have paid for them *ex ante*. Her payment will have been memorialized in a lower price term, which is to say that the promisor's entitlement to the gains from efficient breach is made express in the contract, or at least implied in fact rather than in law. (This approach to the expectation remedy thus sounds in the parties' actual rather than ideal agreement, a point that will become important in a moment.) Indeed, given this arrangement, it would be bad faith for a promisee to insist on specific performance, as this would give the promisee a benefit that he did not pay for and deprive the promisor of one of the benefits that the contract expressly gave her.[53] The expectation remedy thus does not eliminate contractual sharing (including of the surplus generated by "efficient breach") but instead cabins contractual surplus sharing according to the parties' agreement, *ex ante*.[54]

In this way, the expectation remedy vividly embodies the attitude towards contractual obligation associated with good faith and brings the structure of the contract relation into line with this attitude. Good faith thus establishes a contrast to what the contract relation would be like were it governed by a regime of reciprocal fiduciary obligation between promisor and promisee. The fiduciary regime would require each party to display affirmative other-regard within the contract and to adjust its conduct not only to vindicate whatever expectations were fixed by the parties *ex ante* but also

Va. L. Rev. 1939 (2011); Daniel Markovits & Alan Schwartz, *The Expectation Remedy and the Promissory Basis of Contract*, 45 Suffolk U. L. Rev. 799 (2012) (symposium in honor of the 30th anniversary of the publication of *Contract as Promise*); and Daniel Markovits & Alan Schwartz, *The Expectation Remedy Revisited*, 98 Va. L. Rev. 1093 (2012).

[52] The parties will generally prefer this, as the overall gains from trade (which the parties may divide however they can agree) will be greater under the expectation regime than under a property right regime.

[53] Moralists who criticize the expectation remedy and "efficient breach" for, in effect, encouraging promisor bad faith miss this point. Examples include: Richard R. W. Brooks, *The Efficient Performance Hypothesis*, 116 Yale L.J. 568 (2006); Melvin Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 Calif. L. Rev. 975 (2005); Melvin Eisenberg, *The Disgorgement Interest in Contract Law*, 105 Mich. L. Rev. 559 (2006); Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. Legal Stud. 1 (1989); Seana Shifrin, *Could Breach of Contract Be Immoral?*, 107 Mich. L. Rev. 1551 (2009); Seana Shiffrin, *The Divergence of Contract and Promise*, 120 Harv. L. Rev. 708 (2007).

[54] Specific performance is not different in this respect. Rather, it simply shifts the control over the contractual trade from the promisor to the promisee, whom it empowers to be self-interested within the contract in just the manner in which the expectation remedy empowers the self-interest of the promisor.

At least in the general run of cases, such a reallocation would reduce overall contractual surplus, for reasons having to do with transactions costs. The traditional specific performance remedy draws the promisee into the promisor's perform-or-breach decision, by giving the promisee a right to demand performance. But it does not exclude the promisor from that decision, as she retains her right simply to perform. This is an odd way of speaking, but it matters. Where a promisee entitled to specific performance demands too great a share of the gains from an efficient breach, a promisor will threaten to deprive the promisee of the gains entirely, simply by performing. The strategic setting associated with traditional specific performance thus requires a transactions costly, and hence inefficient, *ex post* renegotiation.

fairly to balance its and its counterparties' interests as these develop *ex post*. Such fiduciary arrangements are possible and indeed are recognized in law. But they remain starkly and expressly different from the contract relation.[55]

Contractual good faith is thus thin (being limited to respect for an antecedently and independently agreed surplus allocation) and flexible (being open to any surplus allocation on which the parties have so agreed). But it is neither inconsequential nor slight. Indeed, contractual recognition, although it arises at arm's length, possesses a value in which more intimate forms of recognition cannot share. Among other things, thinness reconciles the mandatory duty of good faith with freedom of contract. In addition, the structure of good faith corresponds to the formal equality that contract law embeds elsewhere in doctrine. Most importantly, good faith (rightly understood) establishes contract as a collaborative relation and places this relation at the center of the distinctive form of social solidarity established through market exchange.

The contrast between contractual good faith and fiduciary obligation—the principle that good faith does not establish intimacy or affection so much as articulate respect among parties who remain at arm's length—is worth exploring in the light of these claims. To begin with, this contrast illuminates the relationship between good faith in performance and freedom of contract—the fashion in which the duty of good faith serves as the core doctrinal expression of freedom of contract. Furthermore, the contrast reveals the character of contractual recognition and market solidarity.[56]

It is commonly said that the degree of other-regard required by contract is *less* than that required of fiduciaries. In one sense, the account just elaborated supports the commonplace view: if a beneficiary asks his fiduciary to walk a mile with him, she must, altruistically, walk with him twain; a contractual promisor, by contrast,

This reveals that in order to be as efficient as the expectation remedy, a specific performance rule would have to give promisees a right to *require* promisors to deal with third parties (committing an "efficient breach") and disgorge the gains from such dealing. *See* Brooks, *The Efficient Performance Hypothesis*; Markovits & Schwartz, *The Myth of Efficient Breach*. This requirement renders vivid that the entitlement to self-interest within the contract—and the associated insistence on sharing *ex ante* rather than *ex post*—survives the reallocation of gains associated with replacing the efficient expectation remedy with an efficient regime of specific performance.

[55] For more on the nature of fiduciary loyalty, including as it appears in contrast to good faith, *see* Daniel Markovits, *Sharing* Ex Ante *and Sharing* Ex Post: *The Non-Contractual Basis of Fiduciary Relations in* The Philosophical Foundations of Fiduciary Law (Andrew Gold & Paul Miller eds., forthcoming 2014).

Commentators do not always appreciate the structural difference between good faith and fiduciary loyalty and sometimes understand the two as what D. Gordon Smith calls "variations on a theme." D. Gordon Smith, *The Critical Resource Theory of Fiduciary Law*, 55 Vand. L. Rev. 1399, 1487 (2002). More specifically, Smith proposes that "[b]oth [fiduciary duty and good faith] are judicially imposed loyalty obligations designed to attack the potential for opportunism in relationships" (at 1487–8). Smith further asserts that good faith "requires each contracting party to consider the interests of the other contracting party when contemplating self-interested actions. To that extent, the duty of good faith is similar to fiduciary duty" (at 1488).

This is error, both about doctrine and about doctrine's deeper normative structure. Good faith, once again, looks backwards, to the contract and its allocation of benefits and burdens; fiduciary loyalty looks forwards, to balance the parties' interests as conditions develop.

[56] *See generally* Daniel Markovits, *Market Solidarity*, Inaugural Lecture as Calabresi Professor of Law, Yale University (Apr. 9 2012), *available at* <http://vimeo.com/40731104>.

may self-interestedly walk only the mile that she promised, and not an inch further. But contractual good faith is not simply a lesser version of fiduciary other-regard—altruism light, as it were. Rather, contractual good faith involves a distinctive form of recognition of the other to whom it is owned—a form of recognition that fiduciary altruism forecloses, or at least impedes.[57]

A fiduciary's obligation to take the initiative on her beneficiary's behalf is coupled with an entitlement to pursue the beneficiary's interests as the fiduciary sees them, including even where the beneficiary takes a different view. These are two sides of fiduciary intimacy's single coin, as altruism becomes quite literally a nonsense in the absence of a right, in the altruist, to promote the other's true interests rather than false ones. This thought is reflected in fiduciary law, through doctrines that limit the terms on which a beneficiary might engage a fiduciary. Broadly speaking, fiduciary arrangements must hold fiduciaries to standards of reasonable care on their beneficiaries' behalves and must give fiduciaries a right to pursue their independent judgments in their exercise of this care. Doctors must sometimes override the choices of their patients, for example, and lawyers must override the choices of their clients; at least, they must both sometimes refuse to go along with self-destructive or even just imprudent client initiatives. Beneficiaries cannot impose their unreasonable preferences or beliefs on their fiduciaries.

By contrast, a contractual promisor's entitlement to good faith self-interest comes with an obligation to take her counterparty's intentions at face value. Both are, equally, expressions of the contractual arrangement—to go only the distance, and only along the path, that the contract to which she and her collaborator agreed specifies. The contractual promisor's freedom from any altruistic obligation thus also deprives her of any entitlement to promote her perspective over her promisee's. Just as fiduciary altruism carries with it paternalism and associated limits on the freedom of the beneficiary, so good faith self-interest (the fact that a promisor may, within the constraints of the contractual agreement, remain as self-interested within the contract as she was without it) carries with it anti-paternalism. Anti-paternalism is, in fact, just another facet of freedom of contract, as a promisee subjected to the mercies of her promisor's paternalism within the promise would be deprived of promise as a reliable mechanism for pursuing her own purposes (a deprivation that the promisor's altruism reduces not one whit).

Finally, returning to the connection between good faith and freedom of contract casts the inter-subjective recognition involved in every contractual exchange in a revealing light. Fiduciaries, because of their altruism and the paternalism that this carries with it, recognize their beneficiaries in terms of their peculiar, idiosyncratic needs and interests—one might say, as the particular persons they are. Contractual promisors, by contrast, proceeding anti-paternalistically and in good faith, recognize

[57] Doctrine sometimes recognizes and implements this point. One can thus find cases that expressly associate certain rights to good faith in performance with arm's length contracts, by observing that these rights do not arise within joint ventures. *See, e.g.*, *Ray-Tek Services, Inc. v. Parker*, 831 N.E. 2d 948, 953 (Mass. App. Ct. 2005). The fiduciary character of the joint venture entails rights and duties of its own, of course. But these squeeze out, rather than simply add to, certain of the rights and duties associated with contractual good faith.

their promisees for their general intentional capacities to pursue whatever interests and needs they have—one might say, for their generic moral personalities.[58]

In a nutshell, once again, good faith allows contracting parties to remain as self-interested, and as much at arm's length, within the contract as they were without it, *except* that they must accept, as a side-constraint, that the best interpretation of what they agreed to in contracting binds them to limit their self-interest. And the distinctive balance of self-interest and other-regarding constraint articulated by good faith elaborates a particular form of interpersonal recognition and respect.

This chain of characterizations—from good faith to self-interest to anti-paternalism to freedom of contract to recognition of generic personality–generates a striking conclusion, moreover. Contractual recognition (the basis of contractual solidarity) is not lesser but rather different from more intimate forms of recognition. Indeed, the contract relation—precisely because good faith is thinner, more generic, and more abstract than particular, concrete altruism—opens up possibilities for solidarity at arm's length that intimates cannot achieve. Good faith thus underwrites a distinctive form of recognition in which contracting parties recognize one another's expressed intentions, at face value. When they do so, the parties to contracts recognize one another as sovereign wills, whose freedom and hence also choices must be respected. Fiduciary relations lack this variety of respect, not in spite but rather because of the substantive other-regard that they involve.

The connection between good faith and freedom of contract—including through its emphasis that the boundaries of good faith in particular cases are determined by rather than determining the actual intentions and expectations of the parties—goes to the core of good faith and to its structural role in the contract relation. The duty of good faith in performance, once again, is not a separate undertaking of the parties to a contract but an attitude towards whatever undertakings the parties have adopted. To display good faith in contract performance is simply to recognize the authority of the contract, and hence the authority of one's counterparty to insist on performance according to the contract's terms.

The duty of good faith in contract performance thus expresses a commitment to a particular normative (and indeed legal) relation. Honoring the duty involves internalizing the authority structures of that relation and implementing them in one's own practical life. This, incidentally, is why good faith, even as its content may be varied almost arbitrarily by the parties (to take on any substance consistent with there being a contract between them), remains a mandatory rule that cannot be waived. Good faith in performance just is the attitude of taking contractual obligation appropriately seriously. To reject good faith is, in effect, to deny the contractual obligation to which good faith attaches. To make such a denial at the moment of contract formation, as would be involved in a waiver of good faith, is to forswear the intent to obligate. And that necessarily causes contractual obligation to fail from the get-go.

[58] I elaborate this thought in greater detail and argue that the structure of promissory recognition places promising at odds with intimacy in Daniel Markovits, *Promise as an Arm's Length Relation, in* Promises and Agreements 295 (Hanoch Scheinman ed., 2011).

IV. Good Faith as a Pedestrian Ideal

Good faith, so understood, is a private analog—as between the contracting parties—of the public duty to obey the law that arises among citizens generally (and the rejection of good faith is a private analog of the revolutionary's denial of the political obligation to which the duty to obey the law attaches). The analogy between faithfully performing a contract and dutifully obeying the law reveals something important about good faith. The duty to obey the law is not simply a duty to act in accordance with justice or natural law, but rather attaches (defeasibly, of course) to *positive law*. Similarly, the duty of good faith in performance is not simply a duty to coordinate optimally but rather attaches to the *positive contract*—to the contract that was actually agreed rather than to some ideal alternative. Good faith in performance is thus a *pedestrian* ideal, which takes as its lodestar the actual contract that the parties' intentions established rather than the *utopian* contract that it would have been optimal for them to establish. Indeed, good faith underwrites a distinctive, intrinsically valuable relation among the parties, at all, *only* in respect of its pedestrian connection to their actual, concrete intentions.

This is not a trivial or obvious point, and it is not always understood. It is tempting to idealize good faith by connecting it not to what the parties intended—to their actual joint plan—but to what they ought, rationally or ideally, to have agreed, or even just to what they would have agreed *ex ante* had they known then what they have discovered *ex post*. But overlooking the actual in favor of the ideal—rejecting pedestrian good faith (based on the parties' actual agreement) in favor of a utopian alternative (that invokes the agreement that the parties ideally would have struck)—introduces confusions into discussions of good faith.

Natural justice has long tempted political thinkers towards skepticism concerning the authority of merely positive law. Similarly, the rational idealization of good faith has, at various times, attracted all manner of thinkers to resist the positive terms of actual contracts. In private law, the utopian approach to the contract relation is at the moment especially tempting to writers in the economic tradition.

Consider again, and in this light, Judge Posner's opinion in *Frey*. According to Judge Posner, the duty of good faith "is a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute."[59] Good faith, on this approach, is thus just another "way[] of formulating the overriding purpose of contract law, which is to give the parties what they would have stipulated for expressly if at the time of making the contract they had had complete knowledge of the future and the costs of negotiating and adding provisions to the contract had been zero."[60] This is as clear a statement of the utopian approach as can be made: good faith, for Judge Posner, is the doctrinal pathway for making the ideal actual.

That vision of good faith cannot be the right one, however. At least, it cannot be right without in effect eliminating contract as a distinctive legal category, which expresses a peculiar face of human freedom and constructs a distinctive human relation.

[59] *Mkt. St. Assocs. Ltd. P'ship v. Frey*, 941 F.2d 588, 595 (7th Cir. 1991).
[60] *Mkt. St. Assocs. Ltd. P'ship v. Frey*, at 596.

As a shallow matter, the utopian conception of good faith simply does not fit the doctrine. According to the utopian view, the duty of good faith in performance *adds* to the substantive content of every contractual obligation. A utopian duty of good faith would entail that contractual promisors owe their promisees performance that they would not owe otherwise. The additions reflect the gaps between the perfectly efficient contracts that the parties would have made had they reasoned ideally without transactions costs and the inefficient contracts that the parties, given their positive transactions costs, actually did make. But doctrine, once again, expressly denies this: recall the U.C.C.'s insistence that good faith "does not create a separate duty of fairness and reasonableness which can be independently breached."[61] The doctrinal duty of good faith in performance is not a separate or additional undertaking of the parties to a contract but an attitude towards whatever undertakings the parties have adopted.

This feature of the doctrine is no accident, moreover. Rather, utopian conceptions of good faith would betray the deep structure of contract law.

To see why good faith cannot be understood in this utopian fashion, begin by observing that a gap inevitably exists between the ideal contract and the contract that the parties have actually made. In some cases, parties expressly adopt optimal terms. (Quantity terms set by sophisticated parties are likely optimal, for example.) In others, there exist good reasons to suspect that silent parties have in fact struck the optimal agreement. (One such case, familiar from earlier discussion, concerns the expectation remedy, which may profitably be understood in terms of a legal presumption that otherwise silent parties have, through a contract's price term, adopted an efficient liquidated damages clause.) But in many cases, it will be clear (or even just on balance the best view) that the parties are interacting on terms that are not optimal. In some cases, parties who have established no contractual relation at all would be better off had they established one. In others, parties have made a contract but on terms whose departure from the optimum has been undeniably memorialized in the express terms of their agreement. In still other cases, the parties' intentions receive only implicit expression, in the interstices of their express agreement, but the best reconstruction of the parties' real contractual intentions again departs from the ideal, optimal contract.

This is not just contingently but necessarily so. Parties to contracts, needless to say, do not reason perfectly or costlessly in their contractual practices; and the costs that they face are reflected in the divergence between agreements that the parties actually make and the ideal agreements. This divergence is inevitable and indeed a transcendental condition of the parties' contracting at all. If persons really could reason perfectly and costlessly in the manner that utopian good faith imagines, they would have no need of, and hence would not (and could not rationally) resort to contract. Rather than ordering their affairs by private agreements, perfectly and costlessly rational parties would engage in ideal public social planning to arrange all their affairs maximally well (efficiently, let us say) for all time. For perfectly, costlessly rational parties, private law, including contract law, is otiose: the only contract that they require is the social contract. Perhaps (and foreshadowing an argument to come) even the social contract

[61] U.C.C. § 1-304 cmt. [1].

would be otiose for such creatures, as they might all instantly agree to live by a unanimously affirmed principle of natural justice.

So actual contracts *necessarily* and indeed *constitutively* depart from the ideal. And in all cases in which the actual departs from the ideal—involving suboptimal failures to contract *tout court*, suboptimal express contract terms, and suboptimal implied in fact contract terms—good faith depends, at least partially, not on what would have been optimal for the parties to agree but rather on what they did agree. Whenever the actual depart from the ideal contractual intentions, the obligations that these intentions create turn not on what would have been optimal for the parties to agree but rather on what they did agree. Treating imperfectly rational parties as if they were perfectly rational, by giving good faith in their contractual relations a utopian bent, therefore undermines their actual contract practices in the service of an ideal whose content is fixed not according to the contracting parties' intentions, but rather according to the court or other lawgiver that determines what is ideal. A utopian standard of good faith, which looks to an ideal rather than to the parties' actual contract, thus violates the parties' contract under the guise of perfecting it. In this way also utopian good faith turns its back on contract.

This recounting of the good faith's insistently pedestrian character is not just a pedantic emphasizing of the contingent and concrete against the universal and abstract, moreover. The distinction between pedestrian and utopian is essential to the character of good faith—really, to the character of the contract relation elaborated in terms of good faith. A utopian standard of good faith, which looked to an ideal rather than to the parties' actual contract, would undermine rather than promote contractual values. Indeed, just as pedestrian good faith promotes freedom of contract and constitutes the contract relation as a site of recognition, so utopian good faith undermines both contractual freedom and recognition.

The connection between the pedestrian account of good faith and freedom of contract is easy to see (and reaffirms that good faith, in spite of being a mandatory rule, *promotes* freedom of contract). Pedestrian good faith protects the parties' actual contractual intentions against *ex post* exploitation, thereby allowing the parties to project their intentions into the future. Good faith is of a piece with contract law's negative libertarian elements. Pedestrian good faith serves rather than limiting freedom of contract by insistently refusing to require the parties' agreement to adopt any particular terms, or even to make any particular division of contractual surplus, but only to respect whatever division they have agreed. By contrast, utopian good faith imposes on the parties a bargain that they did not make. That the parties would be better off under the ideal bargain than under their actual one does by itself eliminate the imposition. Nor does the possibility that the parties would have chosen the ideal bargain had they perfected their deliberations. The fact that pedestrian and utopian good faith come apart entails that the parties did not perfect their intentions.[62]

[62] None of this is to deny that contracting parties might, *in some instances*, form the actual intention that gaps in their contractual understandings shall be filled in using ideal terms. Once again, the discussion of the expectation remedy illustrates just such a case. But there will also arise cases in which the parties' actual intentions either expressly or by clear implication depart from the ideal. And a contract

Utopian good faith thus necessarily encroaches on actual freedom, in the sense associated with negative liberty, in the name of ideal freedom, or positive liberty. This is just the private law analog of the more familiar public law thought that the utopian social contract—the idea that the state is constructed perfectly to instantiate ideal justice and that merely positive law can have no free-standing authority of its own—undermines collective political freedom, replacing democratic sovereignty with a tyranny of rights. The economic focus of utopian good faith in private law—the effort to attribute to the parties whatever intentions would have maximized the value of their bargain—is just a reference to positive liberty dressed up in negative libertarian clothes. That is the commonest apology of the paternalist.

The connection between pedestrian good faith and contractual recognition travels only slightly father afield. Utopian good faith, recall, reconstructs contracts according to ideal efficiency, that is, without reference to the actual intentions of the contracting parties. A party who applies utopian good faith to her own contractual performance can thus proceed without engaging her counterparty at all—she can reason in isolation rather than together with him. This is rendered vivid by imagining a world in which persons deliberate in the fashion that utopian good faith envisions. If persons could deliberate and coordinate *ex ante* in the perfect and costless style that utopian good faith attributes to them *ex post*, then all contracts would be unambiguously complete, so that it would be possible to perform and assess them purely mechanically, with no faith at all, either good or bad. Contracts would, literally, cease to involve a leap of faith. They would also cease to involve respect or recognition among the parties to them, or indeed to involve communication at all. The parties, being ideal and costless deliberators, would each know the other's intentions without needing to be told, just as ideal reasoners would all commonly know the entire truth without needing to communicate. This is why, as I observed earlier, persons who deliberated in the perfect and costless fashion imagined by utopian good faith would not pursue individual engagements with one another at all. Creatures capable of planning perfectly do not need private, obligation-based coordination mechanisms to supplement public coordination. They can simply make their public arrangements perfect, and then optimally achieve all their purposes by living perfectly within them.

Good faith is, in this respect, a practical analog to the principle of charity in interpretation of theoretical communications, a point that sometimes comes out in the cases.[63] Thus, Judge Posner observes that "whether we say that a contract shall be deemed to contain such implied conditions as are necessary to make sense of the contract, or that a contract obligates the parties to cooperate in its performance in 'good faith' to the extent necessary to carry out the purposes of the contract, comes to much the same thing."[64] Note, further, that the analogy to the principle of charity again rejects utopianism in favor of a pedestrian reconstruction of good faith. The principle

cannot arise simply out of a *general* intention in favor of optimal exchange, as this necessarily remains too abstract to resolve concrete questions. The analogy to the law is again helpful here. As a public order cannot be established simply by justice but requires positive law, so a contract cannot be established simply by ideal intentions but requires actual ones. Like utopian politics, so utopian contract is quite literally impossible—both practices are by their nature pedestrian.

[63] An exchange with Charles Fried helped me to recognize the importance of this analogy.

[64] *Mkt. St. Assocs.*, 941 F.2d at 596. The connection between good faith and contextual interpretation also figures in the history of the doctrine. Harold Dubroff thus observes that many of the earliest

of charity requires placing a favorable gloss on what has been said rather than assuming that the truth is always and already known. The utopian assumption would undermine the principle's connection to interpretation, by depriving it of a text to interpret. Once again, if the truth is always known even without being said, then communication becomes otiose.

These observations merely emphasize in an extreme case a basic objection to utopian good faith quite generally. By drawing its content out of the thin air of reason and quite apart from any concrete intentions or contractual engagements, utopian good faith replaces contractual recognition and solidarity *among the parties* with each party's substantively identical but wholly separate relation to right reason. Parties who operate their contracts according to utopian good faith might, to borrow a form of words from Hume, be *in agreement*; but there is not *an agreement* among them. And without a contractual agreement to serve as a substrate to sustain it, there can be no contractual recognition, either.

The analogy between private contracts and the social contract once again usefully develops this point, by illuminating the private contract relation in the brighter light of its more familiar public counterpart. Just as utopianism has tempted theorists of good faith in private contract, so it has been tempting for political philosophers to idealize the social contract. Indeed, the dominant strains of the social contract tradition have succumbed to and even embraced this temptation. The perfect social contract is not political but rather replaces politics, supplanting the actual (republican or democratic) exercise of collective sovereignty with an idealized or just social order (whose terms, enforced by technocrats or philosopher-judges) are designed precisely to constrain actual, concrete politics. The perfect completeness of the social contract thus eliminates the need for political action and agreement in the everyday sense. And the social contract enjoys its authority on the basis of its rationality or justice and not in virtue of having been adopted by any politically constituted sovereign. For the utopian, as Rawls admits, we "submit our conduct to democratic authority only to the extent necessary to share equitably in the inevitable imperfections of a constitutional system."[65]

Perfectly rational and reasonable creatures would not require politics or any political agreement—they would coordinate perfectly justly, but also perfectly separately, being once again in agreement without reaching an agreement on a constitution for their political life. Imperfectly rational and reasonable creatures subject to rule by an idealized social contract fail even to be in agreement and hence experience the constraints on their sovereignty that the social contract imposes as politically alienating.

American cases on good faith employ the doctrine "to avoid the sometimes harsh results that would otherwise have occurred under the conservative interpretation and gap-filling rules prevalent in the Nineteenth and early Twentieth Centuries." Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 St. John's L. Rev. 559, 562 (2006). I would like to thank Paul MacMahon for pointing this argument out to me.

[65] John Rawls, A Theory of Justice 355 (1971). Rawls gives this thought practical effect in his theory of justice, by removing virtually all important collective decisions from politics in its ordinary sense. Justice, for Rawls, determines the substantive content of policy concerning not just basic liberties but the distributions of all primary goods, including income and wealth, powers and opportunities, and even the social bases of self-respect. *See* Rawls, A Theory of Justice, at 62.

That is why preventing political alienation in our imperfect world requires actual politics.

Politics, moreover, must proceed on formally rather than substantively egalitarian terms. More specifically, the formal equality of democratic citizenship is the only conception of public equality compatible with collective sovereignty in an open political community populated by imperfect moral deliberators and hence condemned to pluralist collective life subject to nonideal positive law. The utopian social contract—the idea that the state is constructed perfectly to instantiate ideal justice and that positive law can have no authority of its own—thus threatens to deny citizens the capacity to constitute themselves, communally, as a sovereign. And private contracts, once again, resemble the social contract. Good faith measures reciprocal recognition among formally equal private contractors just as the duty to obey democratic law measures reciprocal recognition among formally equal public citizens.

It is a mistake, for all these reasons, to treat our actual private law, which is very much required, as simply an effort (not very successful) to approximate the state of affairs in which it did not exist at all. Rather, private law establishes real relations among parties in their actual, imperfectly rational state. These relations have value—intrinsically—and not just as tools. They in fact have value precisely because they are relations of recognition among imperfectly rational creatures, who yet respect one another's rationality. (At the root of this thought is the insistence that the thing to be made sense of is *the contract* and not some idealization thereof—that the entities to be respected are the persons and not some idealizations thereof.) Utopian good faith thus disintegrates contractual recognition just as surely as pedestrian good faith instantiates it.

The contractual duty of good faith in performance is thus necessarily a pedestrian ideal rather than a utopian one, whose content is fixed according to the actual intentions of the imperfect parties rather than the counterfactual intentions that the parties would have formed had they deliberated perfectly.[66] This explains why, as doctrine makes plain, good faith cannot add much to deciding close cases: although the duty of good faith in performance requires the parties to respect each other's reasonable contractual expectations, good faith cannot be called on to identify the reasonable expectations in terms of which it is defined. Whereas utopian good faith might usefully decide cases, by specifying the content of reasonable contractual expectations

[66] Even those who propose utopian reconstructions of good faith in theory accept the ideal's pedestrian limitations in practice. Judge Posner, indeed in the very opinion, in *Frey*, that cast good faith in terms of "complete knowledge" and "zero" contracting costs, is a case in point.

The case concerned what good faith required in connection with a contract for the sale and leaseback of a shopping center. The contract expressly contemplated a further negotiation concerning financing to support additional improvements to the center and stipulated that, should this negotiation fail, the lessee might repurchase the property at roughly the original contract price. That turned out, given movements in the local real estate market, to be a very low price. The lessee initiated the financing negotiations without notifying the lessor of the repurchase option; the lessor refused financing; the lessee sought to exercise the repurchase option; and the lessor refused to convey the land on the ground that the lessee's failure to inform the lessor of the option when it initiated the refinancing negotiations constituted bad faith.

Judge Posner held that the lessee's duty of good faith, on these facts, required only that its silence concerning the repurchase option did not arise out of a subjective intention to trick the lessor into according to its own free-standing substantive principle, pedestrian good faith simply directs a court to contractual intentions whose content must be gleaned from elsewhere, using other means.

V. Good Faith as Contract's Core

The thinness of good faith in performance—the fact that good faith does not require altruism or even modest affirmative other-regard but rather is consistent with remaining as self-interested within the contract as without it—connects good faith to formal rather than substantive conceptions of equality. And the fact that good faith nevertheless requires promisors to recognize the authority of their contracts, and hence also of their counterparties to insist on contract rights, connects good faith to equality of status—namely to the shared status of possessing full and equal contractual capacity.

Certainly contractual good faith remains possible even under conditions of substantive inequality. Nothing in the patterns of recognition and respect immanent in the contract relation depends on the substantive fairness of the division of contractual surplus. Even where one side to a contract has leveraged undeserved bargaining advantages in contract formation, so that the substantive terms of an exchange unfairly favor her over the other, she may perform her contract in good faith. Doing so requires only that she respect the contractual settlement, and hence her counterparty's authority to insist on that settlement, and so declines to exploit additional strategic advantages that arise within the contract (and are perhaps even obtained through it) to revise that settlement still further to favor her. In spite of the substantive unfairness that lies behind contracts in such cases, each party (including the exploiter) continues to assume duties to adjust, in good faith, to new contingencies, in order not to deprive the other party of the benefits that the contract was intended to secure. (That these benefits are unevenly, and indeed unfairly, divided, does not mean that the division has no normative force within the contract, or that either party may undo it to her unilateral advantage.) Contract obligation, one might say, does not depend on setting the world right before contracts are made, or improving the world through contracting, but can instead arise equally in nonideal as in ideal contracting. In this way, contract possesses the power to launder injustice, creating legitimate entitlements between parties where previously there were none and, moreover, inducing the parties to recognize these entitlements.

unwittingly triggering the option, which rendered the lessee's good or bad faith a question for the fact finder. He reached this conclusion even though subjecting the lessee to an affirmative duty to disclose would likely have been efficient, as it would have saved the costs of duplicative efforts by both sides to keep track of the terms of their agreement. Certainly the subjective (no trickery) standard of good faith that Judge Posner settled on is inefficient, as it makes assessing good faith require extensive and expensive fact finding, and hence dramatically increases litigation expenses *ex post*. These points follow Todd Rakoff, *Good Faith in Contract Performance: Market Street Associates Ltd. Partnership v. Frey*, 120 Harv. L. Rev. 1187 (2007).

One suspects that Judge Posner, in deciding the case, had at the back of his mind the actual commercial practices of sophisticated developers, which do not require affirmative other-regard but reject outright trickery. As the opinion says, good faith does not "make every contract signatory his brother's keeper." *Mkt. St. Assocs.*, 941 F.2d at 593. This is language steeped in the reconstruction of actual cultural practice rather than in critique aimed at rationalizing practice according to idealized reason.

Such a formal equality of status is likely the only conception of private equality compatible with freedom of contract in a dynamic open economy populated by non-ideal costly economic deliberators. (Similarly, the formal equality of democratic citizenship is likely the only conception of public equality compatible with collective sovereignty in an open political community populated by imperfect moral deliberators and hence condemned to pluralist collective life subject to nonideal positive law.) Good faith is thus the measure of equal arm's length relations among free contractors in private law (just as the duty to obey democratic legislation is the measure of equal arm's length relations among free citizens in public law). Good faith in contractual performance thus connects the solidarity of the contract relation (solidarity within the contract, one might say) to the broader formal equality that lies at the bottom of the democratic, market-oriented societies in which contract typically flourishes. The doctrinal order and the economic structure thus converge.

The pedestrian account also returns the idea of good faith to its doctrinal beginnings. The discussion of good faith began by observing that it is a distinctively contractual notion, as opposed to an ideal from either tort on the one hand or fiduciary law on the other. This is what it means for good faith to be bounded below by fraud (which even tort law forbids) and from above by fidelity (which fiduciary law requires). Good faith applies not among strangers and is not owed to everyone (like tort duties) nor does it apply only among intimates (like fiduciary fidelity). Rather, it applies among persons who have forged a relationship with each other, structured around a shared understanding of a voluntary obligation, that they do not have with the general mass of humanity. Good faith applies only in respect of this obligation relation, and not in respect of other unrelated dealings and interests even among these persons. This, finally, is why good faith makes no independent contribution to the content of the contract obligation. The measure of good faith is the shared project of the contract; apart from this shared project, the persons' relation continues to be characterized by arm's length dealing.

Good faith thus takes the shared perspective of the contract—the joint activity of the contract's performance—as its lodestar. It is an attitude that the parties display towards each other in virtue of, one might even say (by) respecting, their agreement.[67] Good faith requires the parties to take a certain attitude with respect to whatever terms, whatever division of surplus, they have adopted (to honor these terms, roughly). A promisor cannot, that is, abandon her contractual intentions, including the intention to adjust to unanticipated contingencies in a fashion that secures the success of the contractual collaboration's shared plan. To return to the language of Judge Posner's opinion in *Frey*, and this time to agree with it, contracts "set in motion a cooperative enterprise, which may to some extent place one party at the other's mercy. The parties to a contract are embarked on a cooperative venture, and a minimum of cooperativeness in the event unforeseen problems arise at the performance stage is required even

[67] Note that the account here rejects the long-dominant (but perhaps now more generally retreating) view that good faith "has no general meaning or meanings of its own," but instead merely "serves to exclude many heterogeneous forms of bad faith." Robert Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195, 196 (1968). Good faith does have a general content, which is set out in the main text.

if not an explicit duty of the contract. The office of the doctrine of good faith is to forbid the kinds of opportunistic behavior that a mutually dependent, cooperative relationship might enable in the absence of the rule."[68]

This thought underlies the common view that good faith is essential for preventing the contract relation from becoming a locus of exploitation. In fact, good faith plays a more fundamental role still in contract obligation, although this role remains unacknowledged. Good faith does not just prevent exploitation; it is essential for contract to exist at all. For imperfect planners, who cannot plan clearly for every contingency but whose plans inevitably involve haziness and have gaps, good faith is required to make joint planning possible. Good faith in performance is the attitude that imperfect planners must adopt towards their plans in order for the plans to be joint plans at all. It is, quite literally, the matrix in which a shared perspective is possible.[69]

One is tempted to say, in light of all of this, that good faith is the very essence of contractual solidarity, and hence of contract's contribution to social solidarity overall. To make a contract with another *just is* to adopt attitudes of solidarity in favor of the joint project fixed by the contractual intentions. To make a contract *just is* to accept the duty of good faith in its performance.

[68] *Mkt. St. Assocs.*, 941 F.2d at 595. (internal quotation marks and citation omitted).

[69] It is not coincidence, then, that good faith was often used to overcome the requirement of mutuality of obligation, *See*, *e.g.*, *Imperial Ref. Co. v. Kanotex Ref. Co.*, 29 F.2d 193 (8th Cir. 1928). That requirement reflects the fact that contracts must be joint endeavors. Good faith is the measure of the *ongoing* jointness.