
INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

**THE DOCTRINE OF GOOD FAITH IN INDIAN CONTRACTS:
INDISPENSABLE BUT IGNORED¹****ABSTRACT**

Contracts have increasingly become important parts of our daily lives. While it is evident that parties enter into contracts on an understanding for some benefit, a dishonest and negligent attitude of one party can result in irredeemable loss for the other. The Indian Contract Act, 1872 is the primary legislation that protects parties and regulates contractual relations. However, due to wide discretionary powers given to parties under a contract, actions of one party, well within the terms of a contract may result in harm to the other. The doctrine of good faith is a basic legal principle that has been in existence for a long time. The present study attempts to introduce the doctrine of good faith with a brief historical perspective of the same. Secondly, it accounts for the general concept of good faith by looking at the various definitions and arriving at a working definition. Thirdly, it would shed light on the significance of such a doctrine in the legal arena. Fourthly, the study would analyse the doctrine in India focusing on the scope of lack of enforcement of the same. Then, it would give an international perspective, specifically of U.S.A and U.K, both being common law countries like India to depict two different positions regarding the incorporation of the doctrine. Finally, the paper would conclude with a few recommendations.

Keywords: Doctrine of good faith, Contractual morality, Reasonableness, Indian Contract Act

I. INTRODUCTION

Every day, in the course of social interaction, we enter into a number of contracts, sometimes, even without our express knowledge and reach to an understanding with friends and strangers. Contracts, leaving ample room for the parties to perform their respective obligations in a discretionary manner is evident. Such a space may lead towards a self-interested attitude, well

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within the terms of the contract entered into and consequently, cause a harm to the other party. Often, parties may not be able to foresee every possibility of impending harm on either of them. In such cases, the implied duty of good faith is indispensable. Clearly, “*men must be able to assume that those with whom they deal in the general intercourse of society will act in good faith,*”² This assumption would create reasonable expectations that both the parties would carry out their obligations to the best of their interests. In this sense, the doctrine can be considered a minimal standard rather than a high ideal,³ a general principle or a norm, not only of contract law, but also the law of obligations, property law and even private law. However, the notion of good faith is rather vague and although there has been significant effort across the world to formulate a definite scope of this doctrine, the issue remains unresolved. While this may pose difficulties, there are significant advantages as well, which this paper shall go into.

The notion of good faith has Roman origins⁴ which was further inspired by the Greeks who stressed upon justice and equity. During this time, the doctrine evolved a lot, starting from a formulae system (pre-determined formulae helped in giving approval to certain cases) to a list of right of actions. In this context, *bona fide judicia* (latin for good faith) was born. The good faith rights of action⁵ allowed an active participation of the judge in the cases, often to determine quantum of damages or create new obligations based on morality. In this interpretation, the judge had to often determine whether one parties’ actions were in keeping with the that of an honest person.

In the Medieval period⁶, the doctrine became a rule rather than an exception. In this period, there had been much confusion regarding the terms, ‘good faith’ and ‘equity’, with different legal systems taking different sides. This confusion led to usage of different terms for a single doctrine of good faith, or rather the essence of good faith in the laws of the countries.

Further, into the nineteenth century, the doctrine was given a new force by its recognition and insertion in many legal systems like the French, Belgian, German and Quebec civil codes etc. including the U.S.A whose Uniform Commercial Code establishes the doctrine of good faith.

² Pound, R. (1922). *An Introduction to the Philosophy of Law*. Yale University Press. 188

³ Summers, R. S. (1968). “Good Faith” in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*. *Virginia Law Review*, 54(2), 195.

⁴ Mazeaud, D., Fauvarque-Cosson, B. (2009). *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules*. Germany: sellier.european law publishers. 151

⁵ For a detailed explanation of this, see Id. P-153

⁶ Id. p-154

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II. HYPOTHESIS

The doctrine of good faith is an indispensable part of legal systems, especially the law of contracts and should be explicitly recognized in India in order to preserve the sanctity of contracts and other relevant legal principles.

III. RESEARCH QUESTIONS

1. What is the scope of the doctrine of good faith in India presently?
2. How has the doctrine proved significant and indispensable in case laws in India and around the world (focusing on U.S.A and U.K) in the past?

IV. RESEARCH METHODOLOGY

The research methodology used in the present study is ‘doctrinal research methodology’ to compose a detailed analysis of the legal principle of good faith and provide commentary on the same.

The resources used are secondary, such as case laws, legislation, articles, journals etc.

The doctrinal method has been used in order to conduct a qualitative analysis of the doctrine at hand and provide some insights. It is an in-depth study of particular research questions.

The limitation of the said method is that, it can sometimes over-simplify legal principles, blind to the practical complexities of execution. The researcher has taken care to identify the same.

V. RESEARCH OBJECTIVES

1. The study aims to present a general idea of the concept of good faith taking into account its history of evolution and definitions as given by many.
2. It attempts to give an overview of the scope and recognition of the doctrine in India, specially in Contracts.
3. It studies case laws of two other common law countries to depict the importance of a doctrine of good faith.
4. It aims to show how the doctrine of good faith is indispensable for protecting contractual sanctity in India and requires immediate attention.

VI. FORMULATING A WORKING DEFINITION

According to Black’s Law Dictionary, good faith is “a state of mind consisting in

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(1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage”⁷ As is evident, the notion is a blanket term and because of its wide scope, can appear ambiguous. Nevertheless, it is somehow or other connected to morality and equity, considered a legal-ethical principle and a gateway through which moral values enter law.⁸

Among, other definitions of good faith, Robert S. Summers⁹ describes it as an “excluder”, that is, it does not have a generalized meaning of its own and used to exclude forms of bad faith. He observed that it can be invoked to rule out a varieties of bad faith “*including negotiating without serious intent to contract, abusing the privilege to break off negotiations, entering a transaction without intending to perform or in reckless disregard of prospective inability to perform, nondisclosure of known defects in the subject of sale, abusing superior bargaining power*”¹⁰ etc.

Hence, a working definition of the doctrine of good faith would cover any act done with reasonable skill and diligence, as expected in that particular case, with community standards of honesty, trust and cooperation and the best interests of the other party in mind, that is any act, which is not done with bad faith.

VII. SIGNIFICANCE OF THE DOCTRINE OF GOOD FAITH

The doctrine of good faith is important due to the very nature of contract. A contract is essentially an agreement between two or more parties who reach an understanding on the basis of promises, which are legally enforceable. What allows them to coordinate their activities over long or short periods of time is trust.

The terms and conditions of a contract can be very precise or very vague, depending on the drafting of the same. In common law system, parties usually enjoy a wide discretionary power to interpret the terms. While civil law countries like Germany and France recognise the doctrine

⁷ Garner, B. A. (Ed.). (2009). Black's Law Dictionary (9th ed.). West Publishing Co., Thomson Reuters. 762

⁸ Hesselink, M. W. (2011). The Concept of Good Faith. In Towards a European Civil Code (4th and revised ed.) Kluwer Law International and ARS AEQUI LIBRI. 621

⁹ Supra note 2 at p-201

¹⁰ Supra note 2 at p- 216

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of good faith, the common law countries have been less successful in this regard.

The doctrine is often criticized because of its wide coverage area, which, as alleged, may lead to more ambiguity and uncertainty. The claims are true, but are exaggerated. The doctrine must be incorporated in a manner that does not give way to such misuse.

VIII. DOCTRINE OF GOOD FAITH IN INDIA

India, throughout the years has done very little in recognizing the doctrine of good faith and fair dealing. Nevertheless, some statutes do mention the term. The General Clauses Act, 1897 defines good faith- "*a thing shall be deemed to be done in 'good faith' where it is in fact done honestly, whether it is done negligently or not*".¹¹ On the other hand, section 52 of the Indian Penal Code states that "*nothing is said to be done or believed in "good faith" which is done or believed without due care and attention*".¹² Further, the term "due care and attention" has not been defined anywhere.

Hence, the two definitions are clearly contradictory of each other. The former stresses on honesty, even if negligence is present and the latter states that due care and attention is a must for an act to be done in good faith, that is, loosely the act must not be negligent.

Similarly, in the Indian Contract Act, 1872 the term good faith is not defined anywhere except a mention, here and there. For example, section 223 states that an employer must indemnify the agent against the consequences of an act, regardless of the injury caused to third persons if "*the agent does the act in good faith*".¹³ Section 178A also mentions that in case a pawnor has obtained possession of goods under a contract voidable under sections 19 or 19A and it has not been rescinded, and they pledge it, the pawnee acquires good title "*provided he acts in good faith*".¹⁴ The ambiguity and confusion is clear. As a result, there is no coherent essence or definition of good faith in Indian law.

A. SCOPE IN INDIAN CONTRACT LAW

Even if the term 'good faith' has not been expressly defined in the Indian Contract Act, 1872, it can be understood that it was implied in many sections of the act. The essence of good faith is

¹¹ Section 3(22), The General Clauses Act, 1897

¹² Section 52, The Indian Penal Code, 1860

¹³ Section 223, Indian Contract Act, 1872

¹⁴ Section 178A, Indian Contract Act, 1872

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honesty, as interpreted by the Judiciary in many a cases. In the case of *Kailas Sizing Works v. Municipality of Bhivandi and Nizampur*,¹⁵ the Hon'ble Court explained that-

“In order to act in good faith, a person must act honestly. A person cannot be said to act honestly unless he acts with fairness and uprightness. A person who acts in a particular manner in the discharge of his duties in spite of the knowledge and consciousness that injury to someone or group of persons is likely to result from his act or omission or acts with wanton or wilful negligence in spite of such knowledge or consciousness cannot be said to act with fairness or uprightness and; therefore, he cannot be said to act with honesty or in good faith”

It is imperative, hence, that good faith is interlinked with care and concern in the act that one is obligated to perform. Lack of good faith would naturally mean a lack of skill, diligence, concern or an act of gross negligence.

It is important to note here that a similar kind of language is used in the Indian Contract Act, 1872. Section 212 states that an agent *“is always bound to act with diligence, and to use such skill as he possesses”* and must compensate to the principal *“in respect of the direct consequences of his own neglect, want of skill or misconduct”*.¹⁶ This section implies good faith on the part of the agent, because someone working with diligence and without neglect is bound to be honest in respect of the work they have to perform.

An agent is also bound to use reasonable diligence in trying to communicate with their principal to seek their instructions.¹⁷ On the other hand, a whole transaction entered into by an agent can be repudiated by the principal if the agent has been 'dishonest'.¹⁸

It can be understood from the above examples that the Indian Contract Act, 1872 implies a certain concept of good faith in contracts, which is a reasonable diligence possessed by an ordinary prudent person. The doctrine of good faith is used in insurance companies as well, legally binding the parties to not conceal information or mislead and act honestly.

¹⁵ 1968 SCC OnLine Bom 91 : (1968) 70 Bom LR 554 : AIR 1969 Bom 127 : 1968 Mah LJ 916 at page 557

¹⁶ Section 212, Indian Contract Act, 1872

¹⁷ Section 214, Indian Contract Act, 1872

¹⁸ Section 215, Indian Contract Act, 1872

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Subsequently, in the case of *Union of India v. D.N. Revri & Co.*,¹⁹ the Court held that a contract “*must be gathered by adopting a common sense approach and it must not be allowed to be thwarted by a narrow, pedantic and leglistic interpretation*”. Hence, the essence of a contract must mean benefit for both the parties and the terms should be interpreted in that way. No party can claim to hold the terms strictly even if harming the other. This is particularly the case for commercial contracts which are vulnerable to changes of governmental policies.

Further, to interpret the scope of good faith in contracts, it is important to understand the essence of contracts and what the parties meant when they entered into it. The Hon’ble Court had held in the case of *Swarnam Ramachandran v. Aravacode Chakungal Jayapalan*,²⁰ intention of the parties can be determined from

- (i) the express words used in the contract;
- (ii) the nature of the property which forms the subject-matter of the contract;
- (iii) the nature of the contract itself; and
- (iv) the surrounding circumstances.²¹

B. GAP IN ENFORCEMENT AND INTERPRETATION

There are certain difficulties too, regarding interpretation or recognition of the doctrine of good faith as well as enforcement. The terms of a contract of a common law country, unlike a civil law country, can be wide and vague, as it is less prescriptive in nature. There is extensive freedom of contract and scope of interpretation of the terms. Hence, usually important terms and conditions are expressly mentioned. In such a situation, even if a person performs their obligations well within the terms, it may not be with good faith. Also, the definition of good faith in the General Clauses Act, 1897 would not apply to acts prior to it, such as the Indian Contract Act, 1872 and the Transfer of Property Act, 1882.²² This makes the situation further complicated.

It is important to note here that in the 199th report of the Law Commission of India on ‘Unfair Terms in Contract’²³ addressed the lacunae in the Indian Contract law. It had observed that many a times, “*a contract or a term can be procedurally unfair if it has resulted in an unjust*

¹⁹(1976) 4 SCC 147 at page 151

²⁰ (2004) 8 SCC 689 at page 694

²¹ According to Pollock & Mulla: *Indian Contract & Specific Relief Acts* [(2001), 12th Edn., p. 1086]

²² Supra note 12 p-557

²³ Law Commission of India. (2006, August). *Unfair (procedural & substantive) terms in contract* (No. 199) p-4
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advantage or unjust disadvantage to one party on account of the conduct of the other party or the manner in which or the circumstances under which the contract has been entered into or the term thereof has been arrived at by the parties”.

While proposing the bill, the report recognized situations of procedural unfairness. While some terms can look consensual at first glance, unfairness of bargaining power can result in gross injustice. As of now, the Indian Contract Act, 1872 does not address this issue except for some provisions, like undue influence, which renders contracts void.

There is a gap between recognition of the notion of good faith in contracts, specially and enforcement of the same. It is important to note here that enforcement, in this sense will only take into account judicial interpretations and corresponding case laws. The violation of the doctrine of good faith is not a ground of breach in itself.

IX. DOCTRINE OF GOOD FAITH IN OTHER COMMON LAW COUNTRIES

A. U.S.A

The doctrine of good faith is explicitly recognized in U.S.A, under the Uniform Commercial Code (UCC). Section 1-304 states that “*every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement*”²⁴ It also mentions that good faith “means honesty in fact and the observance of reasonable commercial standards of fair dealing”.²⁵ Further, Section 205 of Restatement (Second) of Contracts puts forth that “*every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement*”.²⁶

Case laws in this regard would show the importance of this doctrine. In the case of *K.M.C. Co. v. Irving Tr. Co.*²⁷ the Court recognized the doctrine of good faith. A lender, in this case had refused to advance a certain amount within the limit without prior notice, which resulted in the collapse of the borrower as a viable business entity. It was held that the lender had breached a duty of good faith as a creditor would have given notice that the funds would be denied.

In the case of *Channel Home Ctrs., Div. of Grace Retail Corp. v. Grossman*,²⁸ a prospective tenant (appellant) and a shop owner (appellee) had entered into negotiations and signed a letter

²⁴ Section 1-304, UCC

²⁵ Section 1-201(20), UCC

²⁶ Section 205, Restatement (Second) of Contracts

²⁷ 757 F.2d 752 (6th Cir. 1985)

²⁸ 795 F.2d 291 (3d Cir. 1986)

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of intent. Then the latter leased the shop another tenant. The Court held that the appellant and the appellee had intended to be bound by the letter of intent and the latter had a duty of good faith towards the former.

Nevertheless, the doctrine of good faith, though explicitly recognised is under-enforced in U.S.A. Paul MacMahon has addressed this issue and had observed that “the courts have declined to enforce these norms to their fullest extent”.²⁹

B. U.K

The U.K does not specifically recognise the doctrine of good faith. Lord Ackner in the case of *Walford v Miles*³⁰ had noted that the duty of good faith was “inherently repugnant to the adversarial position of the parties when involved in negotiations” and “unworkable in practice”. In the case of *Interfoto Picture Library Ltd v Stiletto Visual Programs Ltd.*,³¹ Sir Thomas Bingham had noted that legal systems other than the common law, specially the civil legal system had recognized an overriding principle of good faith in contracts and that “*English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness*”. These alternative mechanisms can be “*consideration, incorporation of terms etc*”³²

However, the recent case of *Yam Seng Pte Ltd v International Trade Corporation Ltd.*,³³ held that-

“Under English law a duty of good faith is implied by law as an incident of certain categories of contract, for example contracts of employment and contracts between partners or others whose relationship is characterised as a fiduciary one. I doubt that English law has reached the stage, however, where it is ready to recognise a requirement of good faith as a duty implied by law, even as a default rule, into all commercial contracts”.

X. CONCLUSION AND RECOMMENDATIONS

Over the study, it has become clear that India stands on a very unclear position regarding the doctrine of good faith in general, specifically in contracts. Whereas, it does recognise it in the Indian Penal Code, 1860, further contradicting it with the definition under the General Clauses

²⁹ MacMahon, Paul (2015) Good faith and fair dealing as an underenforced legal norm. *Minnesota Law Review*, 99 (6). pp. 2051-2110. ISSN 0026-5535, p-2090

³⁰ [1992] 2 AC 128

³¹ [1988] 1 All ER 348 at 353 (CA).

³² For a detailed explanation, see *Supra* note 5 p-202

³³ [2013] EWHC 111

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Act, 1897, however, it barely mentions the doctrine in the Indian Contract Act, 1872. Parties entering into contracts are bound to act reasonably but there is no mention of an overriding duty of good faith and mere existence of such a vague concept of reasonableness cannot be the basis of ignorance of an important doctrine of good faith. The Judiciary has, from time to time tried to enforce the doctrine as an implied term but it is grossly under-enforced and not widely recognized, as is clear from the case laws mentioned. Hence, the scope of the doctrine does depend on judicial interpretation of the same and may not be read into any contract that comes into existence, by itself. The Judiciary may, in order to protect contractual morality, establish the doctrine in certain cases, as it had done.

The importance of the doctrine must be clear by now. In the past, case laws from U.S.A explicitly shows how a duty of good faith is indispensable in order to protect parties from subsequent harm. It is only practical to assume a form of responsibility and promise of carrying the obligation with good faith, arising with the contract.

TESTING THE HYPOTHESIS

This research has been carried using a doctrinal method of legal analysis to gain insights regarding the scope and importance of the doctrine of good faith. It has been observed that it is one of the basic principles of law that has been in existence for a long time. Many countries have recognised the principle and incorporated it. Case laws have shed light on the fact that the doctrine essentially upholds contractual morality. To test the hypothesis there needs to be an extensive research, nevertheless, the preliminary study verifies it.

In the light of the aforementioned, the paper puts forth the following suggestions-

1. The Indian Contract Act, 1872 is the primary legislation dealing with contractual relations in India. It should explicitly recognise the doctrine of good faith and provide for its natural or implied incorporation into any contract that is entered into and enforced. It would protect the parties from arbitrary actions of bad faith (explained before) that are not necessarily breaches by the other, and consequently, contractual sanctity.
2. The Indian Contract Act, 1872 should provide for a coherent definition of the concept of good faith, specifically for contractual relations, specially commercial contracts and insurance. It would help define the scope of the doctrine and limit misuse of the same.

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