Good Faith Performance

Dr. Alan D. Miller[*] *& Dr. Ronen Perry*[**]

* Lecturer, Faculty of Law and Department of Economics, University of Haifa.

** Professor, Faculty of Law, University of Haifa.

The authors are grateful to Gerrit De Geest, Shuky Ehrenberg, Izhak Englard, Bernhard Ganglmair, Mark Geistfeld, Leo Katz, Lewis Kornhauser, Henrik Lando, Ariel Porat, Matthew Spitzer, Eyal Zamir, workshop participants at Tel Aviv University, the University of Amsterdam, the University of Bologna, and the Max Planck Institute for Research on Collective Goods, and participants in the 2012 ALEA conference at Stanford Law School, the 2012 EALE conference at the University of Stockholm, and the 2012 EMLE conference at the University of Ghent for fruitful discussions and valuable comments on earlier drafts. We are also indebted to the editors of the *Iowa Law Review* for their remarkable work on this Article.

INTRODUCTION

This Article aims to unveil and undermine one of the most resonant truisms in contract law. It shows that a dominant criterion used by courts and academics in applying the omnipresent and overarching principle of good faith is essentially flawed. Our argument is innovative in at least four respects. First, it uncovers a common denominator of the major accounts of good-faith performance in case law and academic literature—namely, resort to community standards. While not unheard of, this test has never been recognized or addressed as a unifying thread among the various theories. Second, the Article distinguishes two forms of community standards: common views of morality and common practice. This has never been done before in this context. Third, the Article fiercely challenges the common denominator by proving that all definitions of community standards are either theoretically unsound or impractical. This conclusion undermines the validity of current judicial practice and contemporary legal theories. Fourth, the Article uses a novel theoretical perspective that can be labeled "axiomatic jurisprudence," employing tools from a branch of economics known as social-choice theory. In this respect, it continues our recent publication, which utilized similar tools to analyze the concept of reasonableness in tort law.[1]

The good-faith doctrine is probably one of the most fundamental principles in contemporary contract law,[2] so much so that its relatively recent acceptance in American law is often overlooked. The common law of contracts, as manifested in the first *Restatement of Contracts*[3] and major contract law treatises,[4] did not recognize a general duty of good faith.[5]

---

1. Alan D. Miller & Ronen Perry, *The Reasonable Person*, 87 N.Y.U. L. REV. 323 (2012).

2. *See, e.g.*, 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 393 (3d ed. 2004) ("The concept of good faith has, in a relatively few decades, become one of the peculiarly American cornerstones of our common law of contracts." (emphasis omitted)); Dennis M. Patterson, *Wittgenstein and the Code: A Theory of Good Faith Performance and Enforcement Under Article Nine*, 137 U. PA. L. REV. 335, 341, 343 (1988) (explaining that good faith is "a central principle of contract law" as "[f]ew concepts in modern contract law have received as much attention as 'good faith'"); Robert S. Summers, *Good Faith Revisited: Some Brief Remarks Dedicated to the Late Richard E. Speidel—Friend, Co-Author, and U.C.C. Specialist*, 46 SAN DIEGO L. REV. 723, 726 (2009) [hereinafter Summers, *Good Faith Revisited*] ("[T]here is no obligation in all of the U.C.C. and in general contract law of more overall importance than the general obligation of good faith."); Mark Snyderman, Comment, *What's So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending*, 55 U. CHI. L. REV. 1335, 1370 (1988) ("The obligation to perform in good faith is a 'super-eminent principle' . . . .").

3. RESTATEMENT OF CONTRACTS (1932).

4. *See* Robert S. Summers, *The Conceptualisation of Good Faith in American Contract Law: A General Account*, *in* GOOD FAITH IN EUROPEAN CONTRACT LAW 118, 119 (Reinhard Zimmermann & Simon Whittaker eds., 2000) [hereinafter Summers, *Conceptualization*] (discussing major treatises).

5. *See* Teri J. Dobbins, *Losing Faith: Extracting the Implied Covenant of Good Faith from (Some) Contracts*, 84 OR. L. REV. 227, 228 (2005) ("[I]t did not receive widespread acceptance in the

Admittedly, such a duty had been mentioned by a few state courts by the mid-twentieth century.[6] But it received national acclaim only after Karl Llewellyn, a professed Germanophile and the Chief Reporter for the Uniform Commercial Code ("UCC"),[7] imported the general duty of good faith from the German Civil Code.[8] The publication of the UCC in 1952 was a watershed moment in contract law.[9] Section 1-304 (formerly 1-203) provides that, "Every contract or duty within [this Act] imposes an obligation of good faith in its performance and enforcement."[10] The all-encompassing nature of the concept is fortified by countless references throughout the UCC, in numerous sections[11] and comments,[12] and in various contexts. Its

---

United States until the mid-twentieth century."); Eugene F. Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 VILL. L. REV. 213, 246 (1966) (explaining that the duty of good faith in performance did not fare well in Anglo-American law); Summers, *Conceptualization*, *supra* note 4, at 119 ("Before the 1960s, it could not be said that the American states acknowledged any general obligation of good faith in their contract law."); Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 810 (1982) [hereinafter Summers, *The General Duty*].

6. *See, e.g.*, Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 167 (N.Y. 1933) ("[I]n every contract there exists an implied covenant of good faith and fair dealing."); *see also* Nelson v. Abraham, 177 P.2d 931, 934 (Cal. 1947) (en banc) (quoting *Kirke La Shelle*, 188 N.E. at 167).

7. *See* Summers, *Good Faith Revisited*, *supra* note 2, at 724–25 (discussing Llewellyn's role).

8. BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, §§ 157, 242 (Ger.) (imposing a duty of good faith in the interpretation and performance of contracts); E. Allan Farnsworth, *Duties of Good Faith and Fair Dealing Under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, 3 TUL. J. INT'L & COMP. L. 47, 51–52 (1994) [hereinafter Farnsworth, *UNIDROIT*] (discussing the German roots of the UCC duty of good faith); Saul Litvinoff, *Good Faith*, 71 TUL. L. REV. 1645, 1656 (1997) (same); *see also* James Whitman, *Commercial Law and the American* Volk*: A Note on Llewellyn's German Sources for the Uniform Commercial Code*, 97 YALE L.J. 156 *passim* (1987) (discussing the German sources of the UCC).

9. *See, e.g.*, E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 671 (1963) [hereinafter Farnsworth, *Good Faith Under the UCC*] ("[B]y the time of the promulgation of the Uniform Commercial Code, good faith performance had . . . become a poor and neglected relation of good faith purchase. The Code revives it . . . ."); Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & MARY L. REV. 1223, 1242 (1999) ("The adoption of the UCC breathed new life into the doctrine of good faith.").

10. U.C.C. § 1-304 (2011).

11. U.C.C. §§ 1-309, 2-305(2), 2-306(1), 2-311(1), 2-328(4), 2-402(2), 2-403(1), 2-506(2), 2-603(3), 2-615(a), 2-706(1), (5), 2-712(1), 2A-103(1)(a), (o), 2A-109, 2A-304(1), 2A-305(1), 2A-308(1), (3), 2A-405(a), 2A-508(5), 2A-511(3)–(4), 2A-518(2), 2A-527(2), (4), 3-202(b), 3-302(a)(2), 3-311(a), 3-403(a), 3-404(a)–(b)(2), 3-405(b), 3-406(a), 3-407(c), 3-409(c), 3-416(b), 3-417(a), (d)(1), 3-418(c), 3-420(c), 4-103(a), 4-109(a), 4-207(b)–(c), 4-208(a), (d), 4-209(c), 4-401(d), 4-404, 4-406(d)(2)–(e), 4-503(2), 4A-202(b), 4A-302(b), 5-109(a), 6-107(3), 7-203, 7-206(b), 7-208, 7-209(c), 7-210(e), 7-301(a), 7-304(c), 7-308(d), 7-404, 7-501(a)(5), (b)(3), 7-504(b)(4), 7-508, 7-601(b), 9-321(a), 9-330(a)(1), (b), (d), 9-403(b)(2), 9-405(a), 9-615(g), 9-617(b).

12. *See* Mooney, *supra* note 5, at 247 ("The phrase [good faith] also must appear at least fifty times in the comments . . . .").

importance is strengthened even further by section 1-302(b), whereby the duty of good faith cannot be disclaimed.[13] One commentator correctly observed that the doctrine of good faith is "central to the entire Code"[14] and constitutes one of the three unifying features of the UCC.[15] By the late 1980s, the UCC had been adopted in all states.[16]

Perhaps even more importantly, by the late 1970s, inspired by the UCC, the development of a general duty of good-faith performance in the common law of contracts had become authoritative.[17] While each state has an independent body of general contract law,[18] it is now generally accepted that every contract includes an implied covenant of good faith in its

13. U.C.C. § 1-302(b). However, the parties can define by agreement the standards by which good faith is to be measured. So while specific definition of the standards applicable to a particular matter is possible, the general duty is nondisclaimable. *See* Van Alstine, *supra* note 9, at 1309.

14. Mooney, *supra* note 5, at 248 (internal quotation marks omitted).

15. *Id.* at 222 ("The ultimate affirmative touchstone for judicial decision on commercial contract matters . . . is mercantile good faith and fair dealing."); *see also* Soia Mentschikoff, *Highlights of the Uniform Commercial Code*, 27 MOD. L. REV. 167, 168 (1964) (explaining that good faith is one of the three most important general substantive concepts of the UCC).

16. Emily M.S. Houh, *The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?*, 2005 UTAH L. REV. 1, 1 [hereinafter Houh, *Empty Vessel*]; Summers, *Conceptualization*, *supra* note 4, at 118, 120. The UCC was adopted by most states by the 1960s. Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 666; Mooney, *supra* note 5, at 222 n.15; Summers, *The General Duty*, *supra* note 5, at 813.

17. *See, e.g.*, World's Exposition Shows, Inc. v. Benevolent Protective Order of Elks, No. 148, 186 So. 721, 723 (Ala. 1939) (holding that there is an implied covenant of good faith in every contract); Guin v. Ha, 591 P.2d 1281, 1291 (Alaska 1979) (same); Beaugureau v. Beaugureau, 463 P.2d 540, 542 (Ariz. Ct. App. 1970) (same); Blish v. Thompson Automatic Arms Corp., 64 A.2d 581, 597 (Del. 1948) (same); Crooks v. Chapman Co., 185 S.E.2d 787, 789 (Ga. Ct. App. 1971) (same); Martindell v. Lake Shore Nat'l Bank, 154 N.E.2d 683, 690 (Ill. 1958) (same); Midwest Mgmt. Corp. v. Stephens, 291 N.W.2d 896, 913 (Iowa 1980) (same); Odem Realty Co. v. Dyer, 45 S.W.2d 838, 840 (Ky. 1932) (same); Food Fair Stores, Inc. v. Blumberg, 200 A.2d 166, 174 (Md. 1964) (same); Kerrigan v. City of Boston, 278 N.E.2d 387, 393 (Mass. 1972) (same); Burkhardt v. City Nat'l Bank of Detroit, 226 N.W.2d 678, 680 (Mich. Ct. App. 1975) (same); Faust & Forden, Inc. v. Greenbaum, 421 S.W.2d 809, 813 (Mo. Ct. App. 1967) (same); U.V. Indus., Inc. v. Danielson, 602 P.2d 571, 581 (Mont. 1979) (same); Griswold v. Heat Inc., 229 A.2d 183, 187 (N.H. 1967) (same); Palisades Props., Inc. v. Brunetti, 207 A.2d 522, 531 (N.J. 1965) (same); Weyerhaeuser Co. v. Godwin Bldg. Supply Co., 253 S.E.2d 625, 627–28 (N.C. Ct. App. 1979) (same); Miles v. N.J. Motors, Inc., 338 N.E.2d 784, 787 (Ohio Ct. App. 1975) (same); W. Natural Gas Co. v. Cities Serv. Gas Co., 507 P.2d 1236, 1246–47 (Okla. 1972) (same); Perkins v. Standard Oil Co., 383 P.2d 107, 112 (Or. 1963) (en banc) (same); Ide Farm & Stable, Inc. v. Cardi, 297 A.2d 643, 645 (R.I. 1972) (same); Commercial Credit Corp. v. Nelson Motors, Inc., 147 S.E.2d 481, 484 (S.C. 1966) (same); Zion's Props., Inc. v. Holt, 538 P.2d 1319, 1321 (Utah 1975) (same); H.P. Hood & Sons v. Heins, 205 A.2d 561, 566 (Vt. 1964) (same); Miller v. Othello Packers, Inc., 410 P.2d 33, 34 (Wash. 1966) (same); Chayka v. Santini, 176 N.W.2d 561, 564 (Wis. 1970) (same); *see also* Steven J. Burton, *Breach of Contract and the Common Law Duty To Perform in Good Faith*, 94 HARV. L. REV. 369, 369–71 (1980) [hereinafter Burton, *Breach of Contract*] (discussing case law); Summers, *The General Duty*, *supra* note 5, at 812 (same); *supra* notes 10–16 and accompanying text.

18. Summers, *Conceptualization*, *supra* note 4, at 118.

performance[19] as a matter of common law.[20] Consequently, in 1981, a general duty of "good faith and fair dealing"[21] in the performance and enforcement of contracts was incorporated in section 205 of the *Restatement (Second) of Contracts*.[22] Robert Summers opined shortly thereafter that section 205 "reflects one of the truly major advances in American contract law" in the twentieth century.[23] The prevailing view in American courts is that a disclaimer of the common-law duty of good faith violates public policy, and therefore has no legal effect.[24]

An innovative theoretical analysis of a fundamental doctrine is significant *in se*. Yet, the implications of this Article may go even farther for two reasons. First, although we focus on good faith in contract performance, the concept of good faith is applicable in other contexts of contract law,[25] and is also present in other branches of American law.[26] The meaning may

19. *See supra* note 17; *see also* Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 820–21 (Mass. 1991) (explaining that the implied covenant exists in every contractual relationship); Cenac v. Murry, 609 So. 2d 1257, 1272 (Miss. 1992) (same); Richland Nat'l Bank & Trust v. Swenson, 816 P.2d 1045, 1051 (Mont. 1991) (same); Wilder v. Cody Country Chamber of Commerce, 868 P.2d 211, 220 (Wyo. 1994) (same); Dobbins, *supra* note 5, at 228 (same); Van Alstine, *supra* note 9, at 1226 (same).

20. *See* Thomas A. Diamond & Howard Foss, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 HASTINGS L.J. 585, 585 n.1 (1996) (surveying the cases); Emily M.S. Houh, *Critical Interventions: Toward an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law*, 88 CORNELL L. REV. 1025, 1033 (2003) [hereinafter Houh, *Critical Interventions*] ("[I]n most jurisdictions [the duty] is implied . . . at common law.").

21. The term "good faith" has been used in other contexts, as in the case of good-faith purchase. Coupling it with "fair dealing" usually indicates the specific notion of good-faith performance in contracts. E. ALLAN FARNSWORTH, CONTRACTS 504 n.3 (3d ed. 1999).

22. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); *see also* Summers, *The General Duty*, *supra* note 5, at 810 ("[The Restatement] recognizes and conceptualizes a general duty of good faith . . . in the performance and enforcement of contracts . . . .").

23. Summers, *The General Duty*, *supra* note 5, at 810; *see also* Summers, *Conceptualization*, *supra* note 4, at 120 ("[Section 205] represents one of the three or four most significant changes [between the First and Second Restatements]").

24. *See* Diamond & Foss, *supra* note 20, at 625 (explaining that the covenant cannot be disclaimed); Farnsworth, *UNIDROIT*, *supra* note 8, at 61 (same); Van Alstine, *supra* note 9, at 1226, 1245 (same). The parties can "indirectly waive [the] protections [of the covenant] by expressly authorizing particular conduct." Diamond & Foss, *supra* note 20, at 624.

25. *See* Steven J. Burton, *Good Faith in Articles 1 and 2 of the U.C.C.: The Practice View*, 35 WM. & MARY L. REV. 1533, 1537–39 (1994) [hereinafter Burton, *U.C.C.*] (discussing other relevant contexts); Steven J. Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1, 18–22 (1981) [hereinafter Burton, *Article 2*] (same); Summers, *Good Faith Revisited*, *supra* note 2, at 726 (contending that good faith comes into play in almost any contractual setting).

26. The concept appears, inter alia, in other branches of private law (such as family law and property law) and in different branches of public law (criminal, administrative, tax, and international law). Litvinoff, *supra* note 8, at 1648–49, 1671–73 (discussing Louisiana law).

vary in different contexts, but the main theoretical argument is applicable in many of them. Second, the duty of good-faith performance is not an exclusively American construct. To begin with, the development of a general duty of good-faith performance in American law has had a tremendous impact on other common-law jurisdictions.[27] Moreover, a similar duty has been recognized for more than two centuries in continental European jurisdictions, such as France[28] and Germany.[29] Furthermore, the principles of UNIDROIT (the International Institute for the Unification of Private Law) include a general non-disclaimable duty to "act in accordance with good faith and fair dealing in international trade"[30] in addition to more specific duties of good faith in pre-contractual negotiations.[31] The U.N. Convention on Contracts for the International Sale of Goods,[32] which was adopted by the United States,[33] does not include a general "duty of good faith"[34] but provides that in its interpretation, "regard is to be had to . . . the observance of good faith in international trade."[35] In sum, this Article carries universal implications.

Despite the general acceptance and apparent importance of good-faith performance in the United States, courts and scholars have not been able to agree on the exact meaning of this concept. For many years, no attempt was made to provide clear definitions of good faith, at least in the common law of contracts, and the doctrine was applied somewhat intuitively.[36] But even when courts and scholars have begun to formulate general guidelines, no consensus has crystallized.[37] The result is inconsistency and uncertainty. A

---

27. *See* Farnsworth, *UNIDROIT*, *supra* note 8, at 52–54 (discussing the impact of American law on other common-law jurisdictions).

28. CODE CIVIL [C. CIV.] art. 1134 (Fr.); *see also* LA. CIV. CODE ANN. art. 1983 (2008) ("Contracts must be performed in good faith.").

29. *See supra* note 8 and accompanying text.

30. UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS art. 1.7 (Int'l Inst. for the Unification of Private Law 2010).

31. *Id.* art. 2.1.15.

32. United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 1489 U.N.T.S. 3 [hereinafter CISG].

33. Farnsworth, *UNIDROIT*, *supra* note 8, at 54.

34. *Id.* at 55; *see also* Houh, *Empty Vessel*, *supra* note 16, at 1.

35. CISG, *supra* note 32, art. 7(1).

36. *See* Burton, *Breach of Contract*, *supra* note 17, at 369–70 ("[N]either courts nor commentators have articulated an operational standard that distinguishes good faith performance from bad faith performance. The good faith performance doctrine consequently appears as a license for the exercise of judicial or juror intuition . . . ." (footnote omitted)).

37. *See* Diamond & Foss, *supra* note 20, at 585–86 ("[T]he implied covenant . . . . is shrouded in mystery. Efforts to devise workable standards or relevant criteria for determining when the covenant has been violated have been unavailing."); Dobbins, *supra* note 5, at 228–29 ("[T]here is little agreement about how the common law duty of 'good faith' should be defined or what [it] requires. . . . [T]he cases in which courts have applied the duty of good faith are rife with inconsistencies and confusion, even within single jurisdictions."); Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131, 140 (1989) ("[N]o consensus exists on precisely

good illustration is the renowned case of *Carma Developers (California), Inc. v. Marathon Development California, Inc.*[38] A commercial lease provided that, before subletting the premises, the plaintiff–lessee must give written notice to the defendant–lessor, specifying the terms of the sublease, and that the lessor could then terminate the lease. Several years later, the lessee gave such notice, and the lessor exercised its power of termination to acquire the "increased rental value of the leasehold."[39] The lessee sued for breach of the covenant of good faith. In analyzing the case, the Supreme Court of California conflated all major accounts of the common-law duty of good-faith performance. First, it held that "[i]n the case of a discretionary power, [good faith] requires the party holding such power to exercise it 'for any purpose within the reasonable contemplation of the parties at the time of formation—to capture opportunities that were preserved upon entering the contract, interpreted objectively.'"[40] This is Steven Burton's "recapturing forgone opportunities" theory.[41] Second, the court observed that "the covenant is not susceptible to firm definition" and that "[i]nstead of defining what is consistent with good faith and fair dealing, it is more meaningful to concentrate on what is prohibited."[42] This reflects Robert Summers' "excluder approach."[43] Third, the court held that "[the defendant's] termination of the lease in order to claim for itself appreciated rental value of the premises was expressly permitted by the lease and was clearly within the parties' reasonable expectations."[44] This is an example of what we call a "commutative justice" formulation.[45]

This Article does not endorse a particular definition of good faith. Instead, it unveils a common denominator among the major accounts of good-faith performance and challenges it from a novel theoretical perspective. In doing so, we make two nontrivial methodological assumptions. First, we assume that the concept of good faith is objective, or

---

what the duty of good faith means."); Houh, *Empty Vessel*, *supra* note 16, at 49 ("[C]ommon law good faith standards remain remarkably murky.").

38. Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc., 826 P.2d 710 (Cal. 1992).

39. *Id.* at 712.

40. *Id.* at 727 (footnote omitted) (quoting Burton, *Breach of Contract*, *supra* note 17, at 373).

41. *See infra* Part I.B.

42. *Carma Developers*, 826 P.2d at 727.

43. *See infra* Part I.A.

44. *Carma Developers*, 826 P.2d at 729.

45. *See infra* Part I.C. Another case in which several accounts of good-faith performance were employed is *Best v. United States National Bank of Oregon*, 739 P.2d 554, 557–58 (Or. 1987) (discussing the excluder approach, the commutative-justice rationale, and Professor Burton's "recapturing forgone opportunities" theory). *See also* Farnsworth, *UNIDROIT*, *supra* note 8, at 60 ("American courts have looked to all three of these views for support, often without recognizing a conflict among them. This is not surprising because the meaning of good faith varies according to the context, and the appropriateness of each of the three views will depend on the function the doctrine is called on to serve.").

at least has an objective component.[46] This is far from being self-evident. Indeed, the UCC originally defined good faith as "honesty in fact,"[47] thereby setting a subjective standard.[48] However, adopting a purely subjective definition of good faith would be inconsistent with current conventions[49] and would leave relatively little room for scholarly analysis. We will return to this assumption in the Conclusion.

Second, we assume a contextual approach to contract interpretation. This assumption might be more controversial, but serves a similar purpose. The good-faith performance doctrine plays a meaningful role in contract law only when it can imbue the contract with content. The classical approach to contract interpretation was textualist—as manifested in the "plain meaning rule" and the "parol evidence rule"[50]—and left very limited room for good faith.[51] According to textualists, the express terms of the contract reflect the totality of the parties' agreement, rendering contrary expectations irrelevant.[52] Under this view, good faith could not be invoked to modify contractual terms or restrict contractual powers and therefore has very limited scope of application. By contrast, the modern approach to contract interpretation is contextualist: it searches for the actual agreement of the parties as influenced by context.[53] For instance, according to the UCC, which reflects the contextualist approach, the agreement may be found in the text, or by implication from other circumstances, including course of performance, prior course of dealing, or usage of trade.[54] The Second Restatement similarly provides that "the manifestations of intention of the parties . . . are interpreted as consistent with each other and with any relevant course of performance, course of dealing, or usage of trade."[55]

---

46. *See, e.g.*, *Carma Developers*, 826 P.2d at 727 ("[I]t has been suggested the covenant has both a subjective and an objective aspect . . . . A party violates the covenant if it subjectively lacks belief in the validity of its act or if its conduct is objectively unreasonable.").

47. *See infra* note 249 and accompanying text.

48. *See infra* note 250 and accompanying text.

49. *See, e.g.*, *Carma Developers*, 826 P.2d at 727 ("[T]he covenant of good faith can be breached for objectively unreasonable conduct, regardless of the actor's motive.").

50. *See* Peter Linzer, *The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule*, 71 FORDHAM L. REV. 799, 799–808 (2002) (discussing the plain meaning rule and the parol evidence rule).

51. *See* Van Alstine, *supra* note 9, at 1235 n.44 ("The little that remained for good faith was a secondary role as part of the doctrine of good faith purchase and a much diluted notion of subjective honesty in fact.").

52. *Id.* at 1277.

53. *Id.* at 1237.

54. U.C.C. § 1-201(b)(3) (2011). These terms are defined in U.C.C. § 1-303. For a criticism of the incorporation of trade usages into contracts, see Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 715–17, 777 (1999) (explaining that "the pervasive existence of usages of trade and commercial standards . . . is a legal fiction rather than a merchant reality").

55. RESTATEMENT (SECOND) OF CONTRACTS § 202(5) (1981).

Under this view, the requirement of good faith may incorporate standards of decency, fairness, and reasonableness that depart from express contractual provisions, or restrict contractual powers.[56] We acknowledge what appears to be a move back to textualism in some cases,[57] but emphasize that a fervent retreat in this direction would reduce the importance of good-faith performance and stifle the lively debate on the subject. We shall return to this assumption in the Conclusion as well.

Part I unveils the common denominator of the major accounts of good-faith performance. Subpart A discusses Robert Summers' influential approach, that good faith is an "excluder"—a phrase with no general positive meaning of its own, which serves to exclude a diverse array of concrete forms of bad faith. It then shows how the Restatement, and subsequently case law and even Summers himself, explained that what makes certain types of conduct "bad faith" is the fact that they violate community standards. Subpart B focuses on Steven Burton's equally influential thesis that bad faith occurs where a party uses contractual discretion to recapture opportunities forgone at formation—the latter condition being met if and only if that discretion is exercised for a reason inconsistent with the reasonable contemplation of the parties. Subpart B then explains that expectations about forgone opportunities are linked to customary practice. Subpart C presents a set of common definitions for good faith which derive from and revolve around the idea of commutative justice—namely, enforcement of the parties' actual agreement, or "the spirit of the deal." These include compliance with the parties' justified or reasonable expectations, abstention from conduct that prevents the other party from obtaining the fruits or benefits of the bargain, effectuating the parties' intentions, and faithfulness to an agreed common purpose. Subpart C then shows that both case law and academic literature concur that common practice is highly relevant in ascertaining the parties' intentions

56. *See, e.g.*, Olympic Chevrolet, Inc. v. Gen. Motors Corp., 959 F. Supp. 918, 922 (N.D. Ill. 1997) (holding that although the defendant had discretion under the contract, such discretion was subject to the duty of good faith); Amoco Oil Co. v. Ervin, 908 P.2d 493, 499 (Colo. 1995) (en banc) (affirming a verdict against a lessor for a bad-faith calculation of rent, although contract granted lessor the discretion to set rent); Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 587 (N.J. 1997) (holding that the obligation of good faith applies where the contract expressly permits either party to terminate the contract without cause); Olympus Hills Shopping Ctr., Ltd. v. Smith's Food & Drug Ctrs., Inc., 889 P.2d 445, 451 (Utah Ct. App. 1994) (finding that a supermarket breached the duty of good faith by converting to a discount store although the contract permitted it to operate any lawful retail selling business).

57. *See, e.g.*, Riggs Nat'l Bank of Wash. D.C. v. Linch, 36 F.3d 370, 373–74 (4th Cir. 1994) (holding that the duty of good faith should not override or limit express terms); Hall v. Resolution Trust Corp., 958 F.2d 75, 79 (5th Cir. 1992) (same); Barnes v. Burger King Corp., 932 F. Supp. 1420, 1438 (S.D. Fla. 1996) (same); Cenex, Inc. v. Arrow Gas Serv., 896 F. Supp. 1574, 1580–81 (D. Wyo. 1995) (same); James v. Whirlpool Corp., 806 F. Supp. 835, 843–44 (E.D. Mo. 1992) (same); Farris v. Hutchinson, 838 P.2d 374, 376–77 (Mont. 1992) (same); *see also* Diamond & Foss, *supra* note 20, at 587 n.5 (listing additional cases).

and expectations. Finally, Subpart D analyzes the UCC definition of good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[58] It shows that "reasonable commercial standards" have been widely perceived as being closely associated with community standards.

Part II challenges the common denominator. We begin by showing that the community standards of good faith must be derived from perceptions held by members of a group. These may be perceptions of common practice within an industry or perceptions of morality. A court applying the duty of good-faith performance must ultimately combine these to form a single ("common") perception. We introduce a formal economic model of perceptions of good faith and describe several axioms, or properties, that must be satisfied by any reasonable method of combining these perceptions. Using a theorem from the economic field of social choice, we show that there is only one method that satisfies all axioms, which we term the "nomination rule." According to this method, a behavior must be deemed in good faith whenever it is considered so by at least one person in the relevant set. Because every member of the group would have the power to veto a finding of bad faith, this method is not workable in practice. Consequently, the common denominator is not theoretically sound. A final note—although our analysis is analogous to the groundbreaking theorem for which Kenneth Arrow was awarded the Nobel Prize, our model has been developed specifically to address a legal problem, and is therefore clearly distinct.

I. IDENTIFYING THE COMMON DENOMINATOR

A. GOOD FAITH AS AN EXCLUDER

1. The General Framework

In his very influential paper published more than four decades ago, Robert Summers introduced the argument that good faith is basically an "excluder"—namely, "a phrase with no general [positive] meaning . . . of its own"[59]—which serves to exclude a diverse array of concrete forms of bad faith.[60] Summers contended that no general reductionist definition of good faith could cover all judicially recognized forms of bad faith[61]—especially those not involving dishonesty or negligence—unless it used vacuous abstract terms without intelligible content.[62] The concept may have a concrete meaning in a particular context, but this meaning is simply the

58. U.C.C. § 1-201(b)(20).

59. Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 262 (1968) [hereinafter Summers, *Good Faith*].

60. *Id.* at 196, 201, 262; *see also* Summers, *The General Duty*, *supra* note 5, at 818–19, 827.

61. Summers, *Good Faith*, *supra* note 59, at 206–07, 211–12; Summers, *Conceptualization*, *supra* note 4, at 128.

62. Summers, *Conceptualization*, *supra* note 4, at 128.

opposite of a specific form of bad faith proscribed by the courts.[63] Put differently, one cannot extract a general definition of good faith from case law, only a list of various forms of bad faith from which concrete meanings of good faith derive.[64]

Accordingly, Summers provided a non-exhaustive list of recognized forms of bad faith.[65] Most importantly, judicially recognized forms of bad faith in performance include: (1) evading the spirit of the deal—namely, its underlying rationale, not necessarily manifested in the contract language;[66] (2) lack of diligence and slacking off;[67] (3) willfully rendering only "substantial performance"—that is, imperfect performance that cannot be attributed to mere mistake or inadvertence;[68] (4) abuse of contractual power to specify terms;[69] (5) abuse of power to determine whether the other party's performance complies;[70] or (6) interference with or failure to cooperate in the other party's performance.[71]

Additionally, Summers specified judicially recognized forms of bad faith in dispute management, such as: (1) conjuring a dispute in order to stall or bluff, or disputing capriciously;[72] (2) adopting overreaching interpretations of the contract language, like using general clauses to circumvent more specific ones, or using specific language to evade the fundamental undertaking;[73] or (3) taking advantage of the other party's weakness, such as dependence, lack of knowledge, or necessity, to get a favorable readjustment or a settlement.[74] Summers also listed remedial actions that courts often deem bad faith: (1) abusing the right to obtain adequate assurance of performance (as in repeated refusal to receive given assurances);[75] (2) refusing to accept the other party's slightly imperfect performance;[76] (3) unreasonably failing to mitigate one's own damages;[77] or (4) abusing a contractual power to terminate the contract "at will."[78]

---

63. Summers, *Good Faith*, *supra* note 59, at 201.

64. *Id.* at 202.

65. *Id.* at 203.

66. *Id.* at 234–35; *see also id.* at 216, 217 n.81, 232.

67. *Id.* at 235–37; *see also id.* at 216, 232–33.

68. *Id.* at 237–38; *see also id.* at 203, 216, 233.

69. *Id.* at 239–40; *see also id.* at 216, 233.

70. *Id.* at 240–41; *see also id.* at 216, 233.

71. *Id.* at 241–43; *see also id.* at 217, 233; Dobbins, *supra* note 5, at 262–65 (discussing the obligation not to interfere with the counter-party's performance).

72. Summers, *Good Faith*, *supra* note 59, at 243–44; *see also id.* at 217.

73. *Id.* at 244–46; *see also id.* at 203, 217, 243.

74. *Id.* at 246–48; *see also id.* at 217, 243.

75. *Id.* at 248–49; *see also id.* at 203, 217.

76. *Id.* at 249–50; *see also id.* at 217, 248.

77. *Id.* at 250–51; *see also id.* at 217, 248.

78. *Id.* at 251–52; *see also id.* at 217, 248.

Interestingly, Summers also specified various forms of bad faith in the pre-contractual stage. These include: (1) negotiating without serious intent to contract (as in the case of tailored tenders);[79] (2) abusing the privilege to break off negotiations after inducing reliance by the other party;[80] (3) entering a contract not intending to perform, or recklessly disregarding prospective inability to perform;[81] (4) nondisclosure of known defects in the subject of a sale;[82] or (5) consciously taking advantage of the other party's inferior bargaining power, especially to obtain an unconscionable bargain.[83] This segment of Summers' analysis is thought-provoking primarily because common-law systems have always been reluctant to recognize a duty of good faith in the pre-contractual stage,[84] with very limited exceptions.[85] Neither the UCC nor the Restatement apply a duty of good faith to pre-contractual negotiations and contract formation.[86] However, pre-contractual bad faith is arguably regulated by tort law[87] and a variety of other concepts in the common law of contracts, like incapacity, estoppel, duress, unconscionability, fraud, mistake, and implied collateral contract.[88] In the civil-law world, liability for fault in pre-contractual negotiations is known as *culpa in contrahendo*.[89] In some countries, like Italy, a pre-contractual duty of

79. *Id.* at 216, 220, 221–23.

80. *Id.* at 203, 216, 220, 223–27.

81. *Id.* at 216, 220, 227–28.

82. *Id.* at 203, 216, 220, 228–30.

83. *Id.* at 203, 216, 220, 230–32.

84. *See* Farnsworth, *UNIDROIT*, *supra* note 8, at 57 ("[A] party that enters negotiations . . . bears the risk of any loss . . . incurred if the other party breaks off the negotiations."); Allan Farnsworth, Professor of Law, Columbia Law Sch., Address at the Centro di Studi e Ricerche di Diritto Comparator e Straniero: The Concept of Good Faith in American Law (Apr. 1993), *available at* http://www.cisg.law.pace.edu/cisg/biblio/farnsworth3.html [hereinafter Farnsworth, Address] ("Americans do not recognize a duty of good faith in negotiation . . . .").

85. *See* Houh, *Empty Vessel*, *supra* note 16, at 54 n.369 (explaining that a duty to bargain in good faith exists in American labor law); Friedrich Kessler & Edith Fine, Culpa in Contrahendo, *Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 408 (1964) (same).

86. Summers, *Good Faith*, *supra* note 59, at 220–21, 226; Summers, *Conceptualization*, *supra* note 4, at 121 n.4, 125.

87. *See, e.g.*, Summers, *Good Faith*, *supra* note 59, at 258.

88. *See* Houh, *Empty Vessel*, *supra* note 16, at 4 (explaining that "egregious [precontractual] conduct is sanctionable under the contract doctrines of . . . incapacity, fraud, and duress"); Kessler & Fine, *supra* note 85, at 408 ("Notions of *culpa in contrahendo* and good faith have clearly given rise to many concepts applicable during the negotiation stage, such as the notions of promissory estoppel and the implied in fact collateral contract, which have been employed in order to protect reasonable reliance on a promise."); *id.* at 448 (discussing that notions of *culpa in contrahendo* and good faith include the duty to disclose); *see also* U.C.C. § 1-103(b) (2011) (providing that common-law doctrines supplement the UCC unless explicitly displaced).

89. Kessler & Fine, *supra* note 85, at 401–02.

good faith has been endorsed by the civil code itself,[90] and in others, like Germany, by the judiciary.[91]

Summers' positive account of good faith also inspired a prescriptive position. In his view, a judge should "refuse to adopt restrictive definitions of good faith"[92] and "should not waste effort formulating his own reductionist definitions";[93] instead, the judge "should focus on the forms of bad faith ruled out in previous opinions and work from these opinions either directly or by way of analogy."[94] In other words, the "excluder" approach not only explains what good faith is, but also determines what it should be. The content of good faith is, and ought to be, determined in a traditional casuistic manner.

The impact of the excluder theory has been tremendous. For starters, it has been adopted and applied in numerous decisions throughout the country.[95] One commentator explained that courts simply have more opportunities to find that a party behaved in bad faith than to define good faith.[96] A good example is *Tymshare, Inc. v. Covell*.[97] In that case, the employer–defendant exercised its contractual power to increase the sales quota—which entitled the employee–plaintiff to a special commission—after sales increased dramatically.[98] The court "agree[d] with the observation of Professor Summers that the concept of good faith in the performance of contracts 'is an excluder'" and concluded that "good faith performance is a means of finding within a contract an implied obligation not to engage in the particular form of conduct which, in the case at hand, constitutes 'bad

90. Codice civile [C.c.] art. 1337 (It.).

91. *See* Kessler & Fine, *supra* note 85, at 406–07.

92. Summers, *Good Faith*, *supra* note 59, at 206–07.

93. *Id.* at 207.

94. *Id.*

95. *See, e.g.*, Fremont v. E.I. DuPont DeNemours & Co., 988 F. Supp. 870, 877 (E.D. Pa. 1997) ("The duty of good faith . . . is not susceptible to precise definition and varies with the contractual contexts in which it arises. . . . Although a precise, context-free definition . . . is not readily discernible, courts have identified some forms of bad faith that are excluded [reciting Summers' categories] . . . . With these examples in mind, the record will thus be reviewed to determine whether any identifiable form of bad faith has been evidenced." (citations omitted)); Coca-Cola Bottling Co. of Elizabethtown v. Coca-Cola Co., 769 F. Supp. 599, 652 (D. Del. 1991) (listing various forms of bad faith articulated in the RESTATEMENT (SECOND) OF CONTACTS § 205 cmt. d (1981)), *aff'd in part, rev'd in part*, 988 F.2d 386 (3d Cir. 1993); Best v. U.S. Nat'l Bank of Or., 739 P.2d 554, 557–58 (Or. 1987) (adopting Summers' view); Somers v. Somers, 613 A.2d 1211, 1213 (Pa. Super. Ct. 1992) (listing various forms of bad faith); Garrett v. BankWest, Inc., 459 N.W.2d 833, 841 (S.D. 1990) (adopting Summers' view); Carmichael v. Adirondack Bottled Gas Corp. of Vt., 635 A.2d 1211, 1216–17 (Vt. 1993) (listing various forms of bad faith).

96. Litvinoff, *supra* note 8, at 1665.

97. Tymshare, Inc. v. Covell, 727 F.2d 1145 (D.C. Cir. 1984).

98. *Id.* at 1147–49.

faith.'"[99] It then held that good faith may be used to limit "the reasons for which an express [contractual] power . . . can be exercised,"[100] even where the text seemingly confers unlimited discretion, as under the "abuse of discretion" doctrine in administrative law.[101] The court concluded that in the case of a retroactive reduction of a "central compensatory element of the contract," it is "unlikely that the parties had in mind a power quite as absolute as appellant suggests."[102] The language could not be read to confer discretion to reduce the quota for any reason, including "a simple desire to deprive an employee of the fairly agreed benefit of his labors."[103] Although the court did not specify in which of Summers' categories this case actually fell, there are at least two obvious candidates: evading the spirit of the deal, and abusing contractual power to specify terms.

Moreover, the excluder approach was explicitly endorsed by the *Restatement (Second) of Contracts*.[104] Robert Braucher, the original Reporter for the Second Restatement,[105] acknowledged this endorsement when presenting the draft in 1970.[106] The Restatement, following Summers, does not provide a formal positive definition of good faith. It explains that the meaning of good faith "varies somewhat with the context," and that it "excludes a variety of types of conduct characterized as involving 'bad faith.'"[107] The Restatement then embraces Summers' categories of bad faith as guideposts for the casuistic development of the duty of good faith with respect to performance and enforcement.[108] The excluder approach is also prevalent among scholars. It is deemed one of the most influential

99. *Id.* at 1152 (quoting Summers, *Good Faith*, *supra* note 59, at 201) (internal quotation marks omitted).

100. *Id.* at 1153–54.

101. *Id.* at 1154.

102. *Id.*

103. *Id.*

104. *See* Dobbins, *supra* note 5, at 271 (acknowledging the endorsement); Farnsworth, *UNIDROIT*, *supra* note 8, at 59 (same); Houh, *Critical Interventions*, *supra* note 20, at 1027–28, 1036–37 (same); Houh, *Empty Vessel*, *supra* note 16, at 2, 5, 7 n.42, 50 (same); Summers, *Good Faith Revisited*, *supra* note 2, at 729; Summers, *Conceptualization*, *supra* note 4, at 125; Summers, *The General Duty*, *supra* note 5, at 813, 825 (same); Van Alstine, *supra* note 9, at 1251.

105. *See* Joseph M. Perillo, *Twelve Letters from Arthur L. Corbin to Robert Braucher Annotated*, 50 WASH. & LEE L. REV. 755, 756 (1993) (explaining Braucher's role).

106. *See* Summers, *The General Duty*, *supra* note 5, at 810, 814.

107. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981).

108. *Id.* at cmts. d, e.

contributions to modern contract law[109] and a reigning paradigm of good faith.[110]

Notwithstanding its popularity, this theory has not escaped criticism. Such criticism is beyond the scope of this Article, but we may note the highlights. Under the excluder approach, "each case will be decided on an ad hoc basis without [predetermined] guidelines."[111] This carries the risk of "capricious and unpredictable decision making."[112] Without tying the recognized manifestations of bad faith together under a positive conception of good faith, one cannot know for sure if particular conduct violates the duty of good faith.[113] Additionally, at least some of Summers' examples, intended to mitigate the inherent uncertainty, use opaque terms. For example, "[d]efining evasion of the spirit of the bargain as [an instance of] bad faith . . . assumes that the 'spirit' of an agreement can [actually] be discerned."[114]

2. The Role of Community Standards

A critical question arises regarding the implementation of the excluder approach: In the absence of a positive definition of good faith, what is the source of bad-faith categories? Put differently, what justifies courts in determining that particular conduct is bad faith? The answer to this question is crucial in two respects. First, without an identifiable source, existing categories of good faith can be neither defended nor criticized. We cannot determine whether they are correct or incorrect, justified or unjustified, good or bad. The concept of good faith may seem arbitrary, not to say illusory. Second, and closely related, without such a source, courts cannot recognize or reject new forms of bad faith when the need arises. What, then, is the litmus test for bad faith?

The suggested answers are not mutually exclusive. One possible answer is that categories of bad faith derive from an exercise of judicial discretion, a

---

109. *See, e.g.*, Houh, *Empty Vessel*, *supra* note 16, at 5 (calling Summers' article "one of the most influential in modern contract law"); Patterson, *supra* note 2, at 343 (describing Summers' approach as providing "[t]he most influential perspective on the topic of the proper conceptualization of good faith"); Van Alstine, *supra* note 9, at 1250 (calling the excluder analysis "one of . . . the most influential analyses in the area").

110. *See, e.g.*, Houh, *Critical Interventions*, *supra* note 20, at 1034 (calling Summers' approach one of "two approaches [that] continue to guide ongoing efforts toward formulating a workable standard for the doctrine of good faith"); Patterson, *supra* note 2, at 342–43 ("[M]ost courts and many commentators have accepted [the] 'excluder analysis' as the best statement of the meaning of good faith . . . .").

111. James H. Cook, Comment, Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*: Tortious Breach of the Covenant of Good Faith and Fair Dealing in a Noninsurance Commercial Contract Case*, 71 IOWA L. REV. 893, 899–901 (1986); *see also* Diamond & Foss, *supra* note 20, at 591.

112. Diamond & Foss, *supra* note 20, at 591–92.

113. Patterson, *supra* note 2, at 351.

114. Dobbins, *supra* note 5, at 272 (internal quotation marks omitted).

sort of "I know it when I see it" approach.[115] But this turns good faith into a vacuous shell with no real content where a reasonable level of certainty is of utmost importance. An alternative answer is that, in identifying forms of bad faith, courts aim to conform to the parties' reasonable expectations. Although the excluder approach is sometimes conflated with a "reasonable expectations" test,[116] the latter is more frequently used as an independent test for compliance with the duty of good faith, unrelated to Summers' theory. Therefore, it will be discussed separately below.[117]

The last possible answer is that forms of bad faith are associated with, or derive from, community standards. The Restatement explicitly creates such a link. Comment (a) to section 205 provides, "Good faith performance or enforcement of a contract . . . excludes a variety of types of conduct characterized as involving 'bad faith' *because* they violate community standards of decency, fairness or reasonableness."[118] The word "because" is essential. It denotes that certain types of conduct are considered "bad faith" because they violate community standards. Community standards are the source of the content. This linkage has been endorsed not only by the courts,[119] but also by Summers himself.[120]

Thus, if all or most similarly situated parties would refrain from a particular conduct in certain circumstances, such conduct may be a violation of the obligation of good faith.[121] A few examples will suffice. In *R & G Properties, Inc. v. Column Financial, Inc.*, the Supreme Court of Vermont held that the covenant of good faith has both contextual and fact-specific boundaries, and that it "protects against conduct [that] violates community standards of decency, fairness or reasonableness."[122] In applying this test, the court concluded that "[t]he record shows that [plaintiff] has merely alleged bad faith while presenting no factual evidence to show that [defendant's

115. Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (using this phrase in an obscenity case); *see also supra* note 36 and accompanying text.

116. *See, e.g.*, Fremont v. E.I. DuPont DeNemours & Co., 988 F. Supp. 870, 877–78 (E.D. Pa. 1997) (adopting the excluder approach and then applying a reasonable-expectations test).

117. *See infra* Part I.C.

118. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981) (emphasis added). This language seems to be inspired by Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 671 ("[G]ood faith performance can be measured by an objective standard based on the decency, fairness or reasonableness of the community, commercial or otherwise, of which one is a member.").

119. *See infra* notes 122–26 and accompanying text.

120. *See* Summers, *Good Faith Revisited*, *supra* note 2, at 728–29 (citing the Restatement's definition, which refers to community standards, and explaining that it specifically endorses Summers' own approach); Summers, *The General Duty*, *supra* note 5, at 821, 826 (explaining that the Restatement's reference to community standards conforms to his own perception of the purpose of good faith).

121. Patterson, *supra* note 2, at 386 & n.157.

122. R & G Props., Inc. v. Column Fin., Inc., 2008 VT 113, ¶ 46, 184 Vt. 494, 968 A.2d 286 (quoting Harsch Props., Inc. v. Nicholas, 2007 VT 70, ¶ 14, 182 Vt. 196, 932 A.2d 1045).

conduct] was [anything] more than standard procedure [under the circumstances]."[123] In *Cavanaugh v. Avalon Golf Properties*, the court reiterated the Restatement's formulation linking the excluder approach with community standards,[124] and concluded that "[t]here is nothing in this record to establish that plaintiffs' transaction with [defendant] would violate community standards of decency, fairness or reasonableness."[125] Some courts skip the linkage between the excluder theory and community standards and apply the latter directly.[126]

What neither courts nor scholars provide is a clear meaning of community standards for the purposes of determining good-faith performance. In other contexts, such as obscenity[127] and defamation,[128] community standards denote the common moral evaluation of a particular act or its consequences. Given the established meaning of the term in these contexts, and the moral overtones of the Restatement ("decency, fairness or reasonableness"), there is reason to believe that the Restatement intended to assess compliance with the duty of good faith in view of commonly held moral views.[129] Still, cases like *R & G Properties* imply that, at least in the good-faith context, community standards might be understood differently, as denoting common practice. In other words, community standards may be determined by what people actually do, not by what they believe should be done under the circumstances. This alternative denotation would not have a real practical value in obscenity or defamation cases, but makes sense with respect to commercial interactions. Indeed, it is more in line with the implementation of other definitions of contractual good faith, as this Article will demonstrate in the following sections.

---

123. *Id.* ¶ 55 (internal quotation marks omitted).

124. Cavanaugh v. Avalon Golf Props., LLC, No. E2010–00046–COA–R3–CV, 2011 WL 662961, at *9 (Tenn. Ct. App. Feb. 24, 2011).

125. *Id.*; *see also* Post v. Killington, Ltd., No. 5:07–CV–252, 2010 WL 3323659, at *17 (D. Vt. May 17, 2010) (citing Summers' categories and concluding that "[a]fter ample discovery, plaintiffs do not identify any 'conduct [by defendant] that violates community standards of decency, fairness or reasonableness'" (citations omitted)), *aff'd*, 424 F. App'x 27 (2d Cir. 2011).

126. *See, e.g.*, Interstate Realty Co. v. Sears, Roebuck & Co., No. 06–5997 (DRD), 2009 WL 1286209, at *12 (D.N.J. Apr. 27, 2009) (explaining that the defendant's conduct did not violate community standards), *aff'd*, 372 Fed. App'x 277 (3d Cir. 2010).

127. *See* Miller v. California, 413 U.S. 15, 24 (1973) ("The basic guidelines for the trier of fact must be: (a) whether 'the average person, applying contemporary community standards' would find that the work, taken as a whole, appeals to the prurient interest . . . .").

128. *See, e.g.*, Michael J. Tommaney, *Community Standards of Defamation*, 34 ALB. L. REV. 634 *passim* (1970) (discussing the meaning of community standards in defamation law).

129. *See* Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 671 ("[G]ood faith performance . . . [is] based on the decency, fairness or reasonableness of the community . . . of which one is a member.").

B. RECAPTURING FORGONE OPPORTUNITIES

1. The General Framework

Steven Burton is Robert Summers' most renowned adversary. In a series of articles, he has contended that bad faith occurs where contractual discretion is used to recapture opportunities forgone at formation; put differently, when the discretion-exercising party refuses to bear the expected cost of performance.[130] This definition of good faith consists of two primary components: (1) contractual discretion and (2) recapturing forgone opportunities.

Discretion is the freedom to choose among different courses of action in performing a contractual obligation.[131] It may exist where the parties defer decision on a specific term and confer decision-making power on one of them, or arise from a lack of clarity or as the result of an omission in the express contract.[132] A discretion-exercising party can determine central aspects of the contract. For example, the quantity may be determined by the buyer's requirements or needs or the seller's output; the price may be determined by one party's appraisal or vary with other factors controlled by one of the parties; the contract may give one of the parties the power to determine the time of performance or the contract's duration (through discretionary termination powers); the contract may be conditional on events under one party's control (like a condition of satisfaction with the other party's performance or a condition that another contract or approval be obtained by the party in control).[133] The discretion-exercising party controls the other's expected benefit. Good-faith violation occurs only if the discretion-exercising party causes the other party to lose some of that benefit. According to Burton, discretion is a precondition for employing the doctrine of good-faith performance: good faith "limits the exercise of discretion in performance" conferred on a party.[134] Parenthetically, specific sections in Article 2 of the UCC apply a duty of good faith to specific cases of discretion with respect to quantity, price, and time.[135]

Recapturing forgone opportunities is the second component in Burton's definition. The underlying rationale is that particular conduct should be deemed bad-faith performance "only if in important respects it is like a breach of contract by failing to perform" an express term.[136] A party

---

130. Burton, *Breach of Contract*, *supra* note 17, at 372–73, 378, 387, 403; Burton, *Article 2*, *supra* note 25, at 6, 16.

131. Litvinoff, *supra* note 8, at 1666.

132. Burton, *Breach of Contract*, *supra* note 17, at 380.

133. *See id.* at 380–83, 395–402; Burton, *U.C.C.*, *supra* note 25, at 1545–46; Burton, *Article 2*, *supra* note 25, at 6.

134. Burton, *Breach of Contract*, *supra* note 17, at 372–73.

135. Burton, *Article 2*, *supra* note 25, at 7–11.

136. Burton, *Breach of Contract*, *supra* note 17, at 373–74.

enters a contract believing no greater benefit can accrue by spending the resources necessary for performance elsewhere. Under this belief, each party commits his or her resources to a particular purpose and undertakes to forgo some of his or her "future freedom to pursue opportunities alternative to the contract."[137] If the assumption proves erroneous, a party may seek to recapture forgone opportunities by redirecting the resources committed to performance, thereby failing to perform.[138] A simple breach of an express term "is an attempt by one party to recapture opportunities forgone upon contracting."[139] Now, if bad faith must have the same fundamental characteristic of breach of an express term, it should also involve a party's attempt to "recapture opportunities forgone upon entering the contract."[140]

In entering into a contract, parties choose some among several opportunities and forgo others.[141] The first question, therefore, is which opportunities are actually forgone. In the case of a breach of express terms, the promisee does not receive promised goods, services, or money. As explained above, the promisor employs the resources required for performance in a more lucrative way, forgone upon formation. But as Burton correctly observes, the expectation interest in contracts comprises not only benefits to the promisee, but also the expected cost of performance to the promisor.[142] Put differently, the "promisee's expectations encompass both the subject matter to be received under a contract, and the expected costs of performance by the other party."[143] In Burton's view, good faith may be employed especially when it is necessary "to direct attention to the expected costs of performance—when the benefit perspective is inadequate."[144]

The next question is how courts should determine whether a particular opportunity was forgone. Burton's response is that "forgone opportunities [are] determined by an objective standard, focusing on the expectations of reasonable persons in the position of the dependent parties."[145] A party recaptures a forgone opportunity if and only if it is acting for a reason inconsistent with the reasonable contemplation of the parties.[146] For

137. Burton, *Article 2*, *supra* note 25, at 24.

138. Burton, *Breach of Contract*, *supra* note 17, at 377.

139. *Id.* at 376–77.

140. *Id.* at 378.

141. Litvinoff, *supra* note 8, at 1667.

142. Burton, *Article 2*, *supra* note 25, at 3, 5; *see also* Burton, *Breach of Contract*, *supra* note 17, at 372, 391–92.

143. Burton, *Breach of Contract*, *supra* note 17, at 387.

144. Burton, *Article 2*, *supra* note 25, at 5.

145. Burton, *Breach of Contract*, *supra* note 17, at 390–91.

146. *Id.* at 369, 372–73, 391 (explaining that under the duty of good faith a party must exercise contractual discretion); Burton, *U.C.C.*, *supra* note 25, at 1535–36, 1542–43, 1545–47, 1552, 1557, 1562–63 (same); Burton, *Article 2*, *supra* note 25, at 6, 16, 25 (same). Burton emphasized that this discretion must be exercised for "reasons within the parties' justifiable

example, where the quantity is determined by the buyer's requirements, purchasing the same product from others in a falling market is exercising the discretion for a speculative purpose not contemplated by the parties, because it recaptures the forgone opportunity to buy from others at less than the contract price.[147] On the other hand, there is no breach if a party's requirement has decreased due to technological improvements in its plant or processes.[148] Similarly, in a situation where prices for a particular good are rapidly rising, increasing the required quantity at a fixed contractual price—not for personal use under the contract, but for the purpose of providing the object to others at the higher price—is bad faith where the contract is based on expected self-consumption.[149] But there is no breach if the party with control over requirement consumed more under the contract than from alternative providers, using the benefit of the lower contractual price.[150]

Burton proposes a theoretical justification for his approach. In his view, the good-faith-performance doctrine enhances "economic efficiency by reducing the costs of contracting."[151] These costs "include the costs of gathering information with which to choose one's contract partners, negotiating and drafting contracts, and risk taking with respect to the future."[152] The good-faith "doctrine reduces all three kinds of costs by allowing parties to rely on the law" instead of incurring some of them.[153] These costs are minimized through the imposition of liability on the party who can more cheaply replace the legal rules with express terms, namely the one who has "better information concerning its own alternative opportunities"—the discretion-exercising party.[154] The other party does not know which alternative opportunities may arise for the discretion-exercising party, but it must cover all in express terms to protect itself, and this may be

---

expectations." Burton, *U.C.C.*, *supra* note 25, at 1542; *see also* Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 821 (Mass. 1991) ("It is . . . bad faith to use discretion to recapture opportunities forgone on contracting as determined by the other party's reasonable expectations . . . ." (quoting Burton, *Breach of Contract*, *supra* note 17, at 369, 372–73) (internal quotation marks omitted)); Farnsworth, *UNIDROIT*, *supra* note 8, at 60 ("[Forgone opportunities are] determined by the other party's expectations . . . ."); Summers, *Conceptualization*, *supra* note 4, at 130 ("To determine whether an opportunity was in fact forgone, it is necessary to inquire into the reasonable expectations of the 'dependent party.'"); James J. White, *Good Faith and the Cooperative Antagonist*, 54 SMU L. REV. 679, 683 (2001) ("[T]his is merely a more pointed way of asking about the legitimate expectations of the parties . . . .").

147. Burton, *Breach of Contract*, *supra* note 17, at 396.

148. *Id.* at 396–97.

149. Burton, *Article 2*, *supra* note 25, at 7–8.

150. *Id.* at 8–9.

151. Burton, *Breach of Contract*, *supra* note 17, at 393.

152. *Id.*

153. *Id.*

154. *Id.* at 394.

costly. Thus, many authors consider Burton's view an economic analysis of good faith.[155]

Burton's definition has found ample support in the case law.[156] For example, in *Richard Short Oil Co. v. Texaco, Inc.*, the plaintiff was a wholesale distributor of the defendant's petroleum products.[157] During their relationship, the defendant initiated a "nationwide rebate program whereby a buyer, whose monthly purchases exceeded a certain percentage of its purchases during the base period, received a price reduction."[158] At a certain point, the defendant decided that only purchases up to a certain ceiling would qualify for the rebate.[159] The plaintiff argued that in introducing this cap and altering the terms of the deal, the defendant acted in bad faith because it placed independent distributors at a severe competitive disadvantage as against the defendant's own retail outlets.[160] The court, relying on Burton's framework, concluded that the plaintiff "did [not] produce adequate evidence of the recapture of foregone opportunities, as have other successful claimants in this kind of case."[161] The evidence showed that the defendant "announced that it was introducing the cap . . . before the parties entered into the second contract and before [the plaintiff] accepted that contract."[162]

Burton's analysis is also deemed central and influential in academic literature. One author described it as a "major contribution to the conceptualization of the duty of good faith,"[163] and another opined that it is one of "two approaches [that] continue to guide ongoing efforts toward

155. *See, e.g.*, Houh, *Critical Interventions*, *supra* note 20, at 1034 (contending that Burton's approach is economic); Houh, *Empty Vessel*, *supra* note 16, at 5 (same).

156. *See, e.g.*, Hubbard Chevrolet Co. v. Gen. Motors Corp., 873 F.2d 873, 876–77 (5th Cir. 1989) (relying on Burton); Piantes v. Pepperidge Farm, Inc., 875 F. Supp. 929, 938 (D. Mass. 1995) (same); James v. Whirlpool Corp., 806 F. Supp. 835, 843 (E.D. Mo. 1992) (same); Three D Dep'ts, Inc. v. K Mart Corp., 670 F. Supp. 1404, 1408 n.4 (N.D. Ill. 1987) (same); Sw. Sav. & Loan Ass'n v. SunAmp Sys., Inc., 838 P.2d 1314, 1319–20 (Ariz. Ct. App. 1992) (same); Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc., 826 P.2d 710, 726 (Cal. 1992) ("The covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another."); Warner v. Konover, 553 A.2d 1138, 1141 (Conn. 1989) (relying on Burton); Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 821 (Mass. 1991) (same); Centronics Corp. v. Genicom Corp., 562 A.2d 187, 194–95 (N.H. 1989) (same); U.S. Nat'l Bank of Or. v. Boge, 814 P.2d 1082, 1091–92 (Or. 1991) (same).

157. Richard Short Oil Co. v. Texaco, Inc., 799 F.2d 415, 417 (8th Cir. 1986).

158. *Id.*

159. *Id.* at 418.

160. *Id.* at 421.

161. *Id.* at 422.

162. *Id.*

163. Van Alstine, *supra* note 9, at 1254.

formulating a workable standard for the doctrine of good faith" (Summers' being the other).[164]

Although Burton's approach has been subject to criticism from various angles,[165] the main problem once again seems to be practical. It is often very difficult to determine which opportunities have actually been forgone. After all, the contract encompasses selected opportunities and usually makes no reference to forgone opportunities.[166] In the absence of clear guidelines, courts might have to apply Burton's definition intuitively.[167] This may generate significant costs and arbitrariness. Reliance on parties' expectations does not solve the practical problem. It only modifies the question: How should we determine what the parties' expectations are? Moreover, such reliance may plausibly lead to the conclusion that Burton's approach is not genuinely distinct and can "be subsumed within the 'reasonable expectations' definition of good faith"[168] to be discussed below.[169]

2. The Role of Community Standards

We have argued that expectations as to specific forgone opportunities might be difficult to prove. Recognizing this, Burton provides two auxiliary tests for identifying expectations, and hence forgone opportunities. First, he explains that forgone opportunities are those "that would be regarded as forgone at formation by reasonable businesspersons operating in the commercial setting."[170] Put differently, expectations are examined through an objective lens—that of a reasonable businessperson. The meaning of commercial reasonableness will be discussed in a separate section.[171]

The second, and possibly related, auxiliary test is community standards. According to Burton, the reasonable contemplation of the parties is an objective test "that assumes a normal or ordinary course of events that the parties expect or should expect at the time of contract formation, and with reference to which they implicitly contract, absent express terms to the contrary."[172] But what is normal and ordinary, and therefore expected? The

164. Houh, *Critical Interventions*, *supra* note 20, at 1034.

165. *See, e.g.*, Summers, *The General Duty*, *supra* note 5, at 827 (opining that "the historical evidence favors other rationales," that the alternative moral rationale has real content, and that commentators do not know if the good-faith doctrine actually achieves efficiency).

166. *See* Diamond & Foss, *supra* note 20, at 593–94 (explaining the problem).

167. *See id.* at 594.

168. Houh, *Empty Vessel*, *supra* note 16, at 37.

169. *See infra* Part I.C.

170. Burton, *Article 2*, *supra* note 25, at 24.

171. *See infra* Part I.D.

172. Burton, *Breach of Contract*, *supra* note 17, at 386; *see also id.* at 389 ("Contract law generally endeavors to overcome these limitations by presuming that the parties expect future events to proceed in a normal course and expect each other to behave, absent express terms, in accordance with customary practices of trade.").

answer necessarily coheres with established standards of interpretation that ascertain the intentions of the parties, or their reasonable expectations, based on regularity.[173] Apart from the text, contractual content may derive by implication from other circumstances, including course of performance, prior course of dealing, or usage of trade.[174] Burton opines, therefore, that in applying standards of interpretation and the relevant rules of performance, "good faith calls attention to courses of dealing, usages of trade, and other business practices as to opportunities forgone by the promisor, in addition to those as to benefits to be received by the promisee."[175] In other words, the objective theory of contract interpretation enables us to extract expectations from the ordinary course of business and customary practice,[176] and contract parties may rely on such implications.[177] While course of performance and course of dealing refer to current or previous interactions between the parties, usage of trade refers to community standards or, more accurately, to common practice.

Burton finds support for the linkage between his definition and community standards in *Eastern Air Lines, Inc. v. Gulf Oil Corp.*, decided under the UCC.[178] In that case, the plaintiff–airline had a "requirements contract" with the defendant–oil company for the supply of aviation fuel at certain locations.[179] Oil prices increased following an embargo by oil-producing countries,[180] and the defendant informed the plaintiff that it would repudiate the contract unless the latter agreed to a price increase.[181] The plaintiff sought specific performance. In defense, the defendant contended that the plaintiff breached the duty of good faith by employing a "fuel freighting" strategy, whereby requirements vary from city to city depending on whether it is economically profitable to freight fuel. If the price at one of the defendant's stations was lower, the plaintiff's aircraft loaded more heavily at that station, and less heavily at others, and vice versa.[182] The court found that "fuel freighting is an established industry practice, inherent in the nature of the business," which has been in existence throughout the history of commercial aviation and known to all oil

173. *See* Burton, *Article 2*, *supra* note 25, at 29 ("The identity of forgone opportunities is determined by traditional methods of ascertaining the intentions of the parties, or their reasonable expectations, at the time of formation.").

174. U.C.C. § 1–201(b)(3) (2011).

175. Burton, *Article 2*, *supra* note 25, at 6. He also contends that the good-faith principle underlies in part the standards of interpretation and implication set forth in U.C.C. § 1-203. *Id.* at 23–24.

176. Burton, *Breach of Contract*, *supra* note 17, at 389, 403.

177. *Id.* at 403.

178. E. Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975).

179. *Id.* at 432–35.

180. *Id.* at 433–34.

181. *Id.* at 431–32.

182. *Id.* at 436.

companies.[183] The court further concluded that this "practice has long been part of the established courses of performance and dealing" between the parties in this particular case.[184] Consequently, the plaintiff had not breached the contract.[185] Burton uses this case on at least two occasions to demonstrate that expectations about forgone opportunities may be inferred from customary practice.[186]

C. COMMUTATIVE JUSTICE

1. The General Framework

A set of common definitions for good faith derive from and revolve around the idea of commutative justice—namely, enforcement of the parties' actual agreement, or "the spirit of deals, including their unspecified inner logic."[187] Case law and legal literature provide four major formulations of commutative justice. The first, which we have already mentioned above, requires compliance with the parties' justified or reasonable expectations.[188] Indeed, at least some expectations are manifested in express contractual terms. So, if the duty of good faith adds anything to the contract, it is the protection of reasonable expectations that "the parties have not reduced to express contractual language."[189]

This formulation of commutative justice is probably the most common, and numerous courts have reiterated it over the years.[190] Thus, although the

183. *Id.* at 436–37.

184. *Id.* at 437.

185. *Id.*

186. Burton, *Breach of Contract*, *supra* note 17, at 389 & n.93 ("Expectations as to specific forgone opportunities may be inferred . . . in light of the ordinary course of business and customary practice . . . ."); Burton, *Article 2*, *supra* note 25, at 8 ("[A]n objective interpretation would indicate that Eastern did not forgo the opportunity to engage in fuel freighting when entering into the contract.").

187. Summers, *The General Duty*, *supra* note 5, at 827.

188. *See supra* Part I.A.2, I.B.1.

189. Van Alstine, *supra* note 9, at 1228, 1230.

190. *See, e.g.*, Flight Concepts Ltd. P'ship v. Boeing Co., 38 F.3d 1152, 1157 (10th Cir. 1994) ("[T]he purpose of the good faith doctrine is to 'protect the reasonable expectations of the parties.'"); Tidmore Oil Co. v. BP Oil Co./Gulf Prods. Div., 932 F.2d 1384, 1391 (11th Cir. 1991) (using similar language as the Tenth Circuit, *supra*); Hubbard Chevrolet Co. v. Gen. Motors Corp., 873 F.2d 873, 876 (5th Cir. 1989) (same); Big Horn Coal Co. v. Commonwealth Edison Co., 852 F.2d 1259, 1267 (10th Cir. 1988) (same); MJ & Partners Rest. Ltd. P'ship v. Zadikoff, 995 F. Supp. 929, 932–33 (N.D. Ill. 1998) (same); Ruffalo v. CUC Int'l, Inc., 989 F. Supp. 430, 435 (D. Conn. 1997) (same); Infomax Office Sys., Inc. v. MBO Binder & Co. of Am., 976 F. Supp. 1247, 1251 (S.D. Iowa 1997) (same); Flight Concepts Ltd. P'ship v. Boeing Co., 819 F. Supp. 1535, 1550 (D. Kan. 1993) (same), *aff'd*, 38 F.3d 1152 (10th Cir. 1994); Seal v. Riverside Fed. Sav. Bank, 825 F. Supp. 686, 699 (E.D. Pa. 1993) (same); James v. Whirlpool Corp., 806 F. Supp. 835, 843 (E.D. Mo. 1992) (same); Zeno Buick-GMC, Inc. v. GMC Truck & Coach, 844 F. Supp. 1340, 1349 (E.D. Ark. 1992) (same), *aff'd*, 9 F.3d 115 (8th Cir. 1993) (unpublished table decision); Amoco Oil Co. v. Ervin, 908 P.2d 493, 499 (Colo. 1995) (en banc) (same); Eis v. Meyer, 566 A.2d 422, 426 (Conn. 1989) (same); Schaal v. Flathead Valley

Restatement generally endorses the excluder approach, it also notes that good faith emphasizes "consistency with the justified expectations of the other party."[191] This wording has been quite influential. For example, in *Post v. Killington, Ltd.*, a contract granted the plaintiffs free use of ski lifts operated by the defendant at a ski area for as long as it operated there.[192] The resort was then sold to third parties, and the ski passes expired.[193] The plaintiffs claimed, inter alia, that the defendant violated the duty of good faith by failing to obtain a promise from the new owners to honor these passes.[194] The court, relying on the above quote from the Restatement, held that this did not constitute a justifiable expectation on the part of the plaintiffs.[195]

The same formulation resonates in legal literature.[196] For example, the distinguished jurist Roscoe Pound opined that good faith reflects the idea that "justice demands one should not disappoint well founded expectations which he has created."[197] Similarly, Allan Farnsworth explained that good faith requires "cooperation on the part of one party to the contract so that another party will not be deprived of his reasonable expectations."[198] More recently, another author found substantial agreement among commentators that the doctrine of good-faith performance protects the parties' reasonable expectations.[199]

A slightly less-common formulation defines good faith as abstention from conduct that prevents the other party from obtaining the fruits or benefits of the bargain. Statements of this sort were enunciated in some of the seminal cases on good-faith performance. In *Kirke La Shelle Co. v. Paul*

Cmty. Coll., 901 P.2d 541, 544 (Mont. 1995) (same); *see also* Diamond & Foss, *supra* note 20, at 594 ("Many courts have adopted half of Professor Burton's approach by focusing on the question whether the conduct was beyond the reasonable expectations of the parties . . . .").

191. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981).

192. Post v. Killington, Ltd., No. 5:07-CV-252, 2010 WL 3323659, at *1–2 (D. Vt. May 17, 2010).

193. *Id.* at *7

194. *Id.* at *5.

195. *Id.* at *14, *17 (citing Lopresti v. Rutland Reg'l Health Servs., Inc., 2004 VT 105, ¶ 36, 177 Vt. 316, 865 A.2d 1102).

196. *See, e.g.*, Houh, *Empty Vessel*, *supra* note 16, at 49 ("[T]he implied obligation of good faith and fair dealing requires that neither of the contracting parties perform in a such way that would deprive a counter-party of its reasonable expectations under the contract."); Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 TEX. L. REV. 169, 200–01 (1989) (linking good faith to protection of reasonable expectations); *id.* at 204–05 ("'[G]ood faith' describes behavior that protects the reasonable expectations of the parties."); Patterson, *supra* note 2, at 388 ("[T]he reasonable expectations of the parties are the measure of the good faith of each . . . ."); *see also infra* note 215.

197. 1 ROSCOE POUND, JURISPRUDENCE 413 (1959).

198. Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 669.

199. Van Alstine, *supra* note 9, at 1255–56, 1275–76, 1293–94, 1307, 1311–12.

Armstrong Co., the plaintiff was entitled to one-half of all moneys received by the defendant from the production of a particular play.[200] A few years later, the defendant granted MGM exclusive "talking" movie rights in the play.[201] At the time of formation, talking movies were unknown and could not be contemplated by the parties.[202] The plaintiff argued that it was nonetheless entitled to half of the profits resulting from this grant. The court held that "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."[203] It concluded that the defendant had breached the implied obligation not to render valueless the plaintiff's right to one-half of the benefits of the play's production.[204]

In *Universal Sales Corp. v. California Press Manufacturing Co.*, the plaintiff bought a machine developed by the defendant as part of a cooperative effort to promote and improve it.[205] The contract entitled the plaintiff to receive a share of the profits from selling products based on this model.[206] At a certain point, the defendant developed a variant without the plaintiff's knowledge and lost interest in improving the original model.[207] The plaintiff demanded part of the revenues from selling the new machine. The court held that in every contract there is an implied covenant of good faith, whereby "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."[208] It then concluded that the defendant's conduct destroyed the plaintiff's rights to the fruits of the contract.[209]

This interpretation of good faith appears in many cases.[210] In others, the word "benefits" replaces the word "fruits."[211] This formulation does not

200. Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 164 (N.Y. 1933)

201. *Id.* at 165.

202. *Id.* at 165–66.

203. *Id.* at 167.

204. *Id.* at 168.

205. Universal Sales Corp. v. Cal. Press Mfg. Co., 128 P.2d 665, 669 (Cal. 1942).

206. *Id.*

207. *Id.*

208. *Id.* at 677.

209. *Id.*

210. *See, e.g.*, Emerson Radio Corp. v. Orion Sales, Inc., 253 F.3d 159, 170 (3d Cir. 2001) ("[N]either 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." (quoting Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 587 (N.J. 1997))); Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp., 139 F.3d 1396, 1403 (11th Cir. 1998); Chambers Dev. Co. v. Passaic Cnty. Utils. Auth., 62 F.3d 582, 587 (3d Cir. 1995); Bonanza, Inc. v. McLean, 747 P.2d 792, 801 (Kan. 1987); Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 820 (Mass. 1991); Palisades Props., Inc. v. Brunetti, 207 A.2d 522, 531 (N.J. 1965); 511 W. 232nd Owners Corp. v. Jennifer Realty Co., 773 N.E.2d 496, 500 (N.Y. 2002); Dalton v. Educ. Testing Serv., 663 N.E.2d 289, 291 (N.Y. 1995); Perkins v. Standard Oil Co., 383 P.2d 107, 112 (Or. 1963); St.

"differ appreciably from [protecting] reasonable expectations,"[212] and the two are often used interchangeably.[213] After all, the parties to a contract reasonably expect to obtain the fruits or benefits of the bargain.[214]

A third formulation aims at effectuating the parties' intentions. This formula is sometimes paired with "protecting reasonable expectations,"[215] although, again, it is far from clear whether the two differ in any meaningful way. A fourth and related version defines good faith as faithfulness to an agreed common purpose.[216] This definition is also frequently paired with "protecting reasonable expectations," most notably in and following the Restatement.[217] A party's expectations or intentions are not always revealed or endorsed by the other party. Two parties might have conflicting expectations, making reasonable expectations conceptually distinguishable

---

Benedict's Dev. Co. v. St. Benedict's Hosp., 811 P.2d 194, 199 (Utah 1991); Diamond & Foss, *supra* note 20, at 597–98 (discussing case law); Dobbins, *supra* note 5, at 252.

211. *See, e.g.*, Holland v. Union Oil Co. of Cal., 993 P.2d 1026, 1032 (Alaska 1999) ("This covenant . . . requires at a minimum that an employer not impair the right of an employee to receive the benefits of the employment agreement."); De La Concha of Hartford Inc. v. Aetna Life Ins. Co., 849 A.2d 382, 388 (Conn. 2004); Gaudio v. Griffin Health Servs. Corp., 733 A.2d 197, 221 (Conn. 1999); Cimino v. FirsTier Bank, N.A., 530 N.W.2d 606, 616 (Neb. 1995); High Plains Genetics Research, Inc. v. J K Mill-Iron Ranch, 535 N.W.2d 839, 843 (S.D. 1995); Litvinoff, *supra* note 8, at 1666.

212. Van Alstine, *supra* note 9, at 1276 n.217.

213. Dobbins, *supra* note 5, at 252 n.105.

214. *Cf.* Houh, *Empty Vessel*, *supra* note 16, at 17 ("[Courts] might refer to the parties' reasonable expectations as the reasonably expected 'fruits' or 'benefit of the bargain' . . . .").

215. *See, e.g.*, Burton, *Article 2*, *supra* note 25, at 3 ("[G]ood faith performance . . . [usually] serves to effectuate the intentions of the parties, or to protect their reasonable expectations.").

216. *See, e.g.*, Ford v. Mfrs. Hanover Mortg. Corp., 831 F.2d 1520, 1523 (9th Cir. 1987) (explaining that the doctrine imposes on the parties a duty "to do everything that the contract presupposes they will do to accomplish its purpose"); Diamond & Foss, *supra* note 20, at 595–96 (discussing the parties' purpose for entering the contract and the "fictional" unitary contractual purpose).

217. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981) ("Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . ."); *see also* McIlravy v. Kerr-McGee Corp., 119 F.3d 876, 882 (10th Cir. 1997) (citing the Restatement); Occusafe, Inc. v. EG&G Rocky Flats, Inc., 54 F.3d 618, 624 (10th Cir. 1995) (relying on the Restatement and holding that "good faith performance of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party" (quoting Ruff v. Yuma Cnty. Transp. Co., 690 P.2d 1296, 1298 (Colo. App. 1984)) (internal quotation marks omitted)); Maljack Prods., Inc. v. Motion Picture Ass'n of Am., 52 F.3d 373, 375 (D.C. Cir. 1995) ("[Bad faith conduct] unfairly frustrates the agreed common purposes and disappoints the reasonable expectations of the other party . . . ." (quoting Careau & Co. v. Sec. Pac. Bus. Credit, Inc., 272 Cal. Rptr. 387, 399–400 (Ct. App. 1990)) (internal quotation marks omitted)); St. Benedict's Dev. Co. v. St. Benedict's Hosp., 811 P.2d 194, 200 (Utah 1991) ("[A] party's actions must be consistent with the agreed common purpose and the justified expectations of the other party." (citing RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a)).

from "agreed common purposes." However, courts and scholars have not developed this distinction.

Protecting reasonable expectations, ensuring that the parties obtain the fruits and benefits of the contract, effectuating parties' intents, and carrying forward the purpose of the contract are but four variants of the very same idea, and while the specific words used to determine the content of good faith may be different, the rhetoric is consistent.[218] Not surprisingly, the four variants are used in various combinations, with no serious attempt to distinguish between them. We have mentioned the widespread linkage between "protecting reasonable expectations" and each of the other three. However, courts often use more inclusive combinations. For example, in *St. Benedict's Development Co. v. St. Benedict's Hospital*, the court explained that the duty of good faith requires that each party "will not intentionally or purposely do anything which will destroy or injure the other party's right to receive the fruits of the contract."[219] The court added that, to comply with this duty, "a party's actions must be consistent with the agreed common purpose and the justified expectations of the other party."[220]

All concepts share similar weaknesses. First and foremost, assuming that contracts are interpreted and enforced in light of their purpose, or the parties' intents or expectations, the good-faith doctrine does not seem to add much to the analysis if it only insists on carrying out contracts in light of their underlying purposes, intents, and expectations.[221] Second, it is often difficult to discern expectations, intents, and purposes.[222] Third, no standard exists to determine whether a party's expectations are reasonable or justified.[223] Fourth, while both parties may have given their consent to the contractual language, they may have conflicting purposes, intents, or expectations.[224] Which should be preferred in the case of an inconsistency? As we have shown above, some variants impose on each party a duty to respect the other's expectations. One question is why the party under duty should ignore or concede his or her own expectations, which are equally legitimate. Another question is how such a party is supposed to be aware of the undisclosed expectations of the other party.[225] If a party is unaware of

218. *See, e.g.*, Houh, *Empty Vessel*, *supra* note 16, at 17 (presenting all four as several versions of the same idea).

219. *St. Benedict's*, 811 P.2d at 199.

220. *Id.* at 200; *see also* Bank of China v. Chan, 937 F.2d 780, 789 (2d Cir. 1991) (using different variants of commutative justice).

221. *See* Burton, *Article 2*, *supra* note 25, at 4–5 (explaining this weakness).

222. *See* Dobbins, *supra* note 5, at 254 (explaining this difficulty).

223. *See* Diamond & Foss, *supra* note 20, at 594 (explaining that there is no standard to determine expectations' reasonableness); Dobbins, *supra* note 5, at 256–57 (same).

224. *See* Dobbins, *supra* note 5, at 249, 256–57 (discussing the possibility of conflicting purposes).

225. *See id.* at 277.

the other's expectations, he or she may breach the duty of good faith while complying with all express contractual obligations.[226]

2. The Role of Community Standards

The express terms of the contract are naturally a prime source for the parties' legitimate expectations and intentions and for the agreed common purpose of the contract.[227] So, if contracts were comprehensive and unambiguous, expectations could be easily discerned. But incompleteness and ambiguity are the norm.[228] Consequently, courts implementing commutative-justice formulas rely on external evidence concerning the content of the parties' agreement. Express terms serve as important but non-exclusive evidence. Saying that the good-faith doctrine protects reasonable expectations thus links the content of the duty of good faith to that of the parties' "agreement," flexibly defined, to embrace more than the express contractual terms.[229] Put differently, good faith may protect expectations and intentions "that do not necessarily find expression in the parties' formal agreement."[230]

What, then, are the other sources of reasonable expectations and common purposes? In some cases, external evidence may exist with respect to conscious and well-formed agreement between the parties that is not manifested in the final text.[231] For instance, the fact that a seller made a representation about the goods prior to the formation of the sales contract, and the buyer relied on this representation in deciding to enter into the contract, is reliable evidence of the parties' expectations. If one party leads the other to reasonably believe that certain states of affairs or understandings exist, "good faith requires that those expectations be respected in the enforcement of rights under the . . . agreement."[232]

In other cases, evidence of previous interactions between the parties serves to determine whether particular conduct frustrates justified expectations. Two forms of previous-interaction evidence exist. "Course of performance" is a sequence of conduct between the parties to a particular transaction where the transaction involves repeated occasions for one party's performance, and the other party accepts a specific mode of performance

226. *Id.* at 262.

227. Van Alstine, *supra* note 9, at 1276, 1281.

228. *See* Burton, *Breach of Contract*, *supra* note 17, at 380 n.44 ("It is the potential for a lack of clarity and completeness that necessitates the implication of the good faith covenant in every contract."); *see also* Sanders v. FedEx Ground Package Sys., Inc., 2008-NMSC-040, ¶ 9, 144 N.M. 449, 188 P.3d 1200 (citing Burton, *supra*, on this matter).

229. Van Alstine, *supra* note 9, at 1277.

230. *Id.* at 1281.

231. *Id.* at 1278 (discussing "agreement-like" expectations).

232. Patterson, *supra* note 2, at 384–85.

without objection.[233] "Course of dealing" is a sequence of conduct concerning previous transactions between the specific parties that can be regarded as establishing a common basis of understanding.[234] Both can be used to determine the content of the agreement, and hence the content of the duty of good faith.

However—and this is crucial—in many cases courts cannot deduce expectations from evidence of the parties' interactions—current or previous—and must resort to evidence that is external not only to the formal contract, but also to the actual interaction between the specific parties. Case law and academic literature agree that usages of trade are highly relevant in creating and ascertaining the parties' expectations.[235] A usage of trade is "any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question."[236] In other words, usage is a fact, a "customary practice among a certain class of people, or in a trade, a neighborhood or a large geographical area."[237] Its efficacy derives from the parties' assumed consent.[238]

Given the established link between parties' expectations and general usages, courts applying commutative-justice definitions of good faith may undeniably resort to common practice. The recently decided case of *Sanders v. FedEx Ground Package Systems, Inc.* is a good example.[239] The defendant recruited the plaintiff as an "independent contractor" responsible for pick-ups and deliveries along a specified route.[240] The plaintiff negotiated with other "independent contractors" to purchase their routes, but the defendant

233. U.C.C. § 1-303(a) (2011).

234. *Id.* § 1-303(b).

235. *See id.* § 1-201(b)(3) ("[T]he bargain of the parties . . . [may be] inferred from . . . usage of trade . . . ."); *id.* § 1-303(d) ("[U]sage of trade . . . is relevant in ascertaining the meaning of the parties' agreement . . . ."); John M. Breen, *Statutory Interpretation and the Lessons of Llewellyn*, 33 LOY. L.A. L. REV. 263, 299 (2000) ("[Usage is a form] of contextual evidence . . . concerned with the parties' expectations . . . ."); *id.* at 302 ("[T]he common law clearly recognized the relevance of custom and usage in the process of contract interpretation."); Patterson, *supra* note 196, at 193 (citing 1 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 1-205:2 (1982)) (explaining that usage of trade helps determine the parties' actual intent); Van Alstine, *supra* note 9, at 1278 ("[S]ome [expectations] may arise under the influence of . . . usages of trade."). By contrast, Lisa Bernstein believes that usages should not play an important role in commercial disputes because the pervasive existence of usages is "a legal fiction." Bernstein, *supra* note 54, at 715, 777.

236. U.C.C. § 1-303(c).

237. Breen, *supra* note 235, at 300 (quoting 3 SAMUEL WILLISON & GEORGE J. THOMPSON, A TREATISE ON THE LAW OF CONTRACTS § 649, at 1873 (2d ed. 1936)) (internal quotation marks omitted).

238. *See id.*

239. Sanders v. FedEx Ground Package Sys., Inc., 2008-NMSC-040, 144 N.M. 449, 188 P.3d 1200.

240. *Id.* ¶ 2.

refused to allow him to own more than one.[241] The court acknowledged the common-law duty of good-faith performance,[242] and explained that it protects the reasonable expectations of the parties, requires that neither do anything that injures the other's rights to receive the benefits of the agreement, aims at making the agreement's promises effective, and "emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."[243] To demonstrate bad faith, the plaintiff provided extrinsic evidence whereby "independent contractors" have a right to buy additional routes to expand their businesses.[244] Inter alia, he testified that, prior to the contract's formation, the defendant represented the possibility of expansion.[245] More importantly, other "independent contractors" testified about being told by the defendant's employees that they would have the right to buy additional routes, and that some "independent contractors" already owned multiple routes.[246] The court explained that such evidence helped to interpret the term "independent contractor" in the contract and to grasp the parties' intents and expectations.[247] Although the practice proved in that case might not strictly qualify as usage, the decision shows that expectations protected by the good-faith doctrine may derive from common practice.

D. REASONABLE COMMERCIAL STANDARDS

1. The General Framework

Section 1-201 of the UCC defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[248] Originally, this section defined good faith quite narrowly as "honesty in fact."[249] Most commentators agreed that this requirement had set a subjective standard—namely, the "pure heart and the empty head" test.[250]

241. *Id.*

242. *Id.* ¶ 8.

243. *Id.* ¶ 8 (quoting RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981)).

244. *Id.* ¶ 13.

245. *Id.* ¶ 15.

246. *Id.* ¶ 16.

247. *Id.* ¶¶ 25–26.

248. U.C.C. § 1-201(b)(20) (2011).

249. *See* Burton, *U.C.C.*, *supra* note 25, at 1539 (presenting the original version); Burton, *Article 2*, *supra* note 25, at 2 n.6, 16–17 (same); Farnsworth, *UNIDROIT*, *supra* note 8, at 52 (same); Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 666 (same); Litvinoff, *supra* note 8, at 1656 (same); Patterson, *supra* note 2, at 380 (same); Summers, *Good Faith*, *supra* note 59, at 207 (same); Summers, *Good Faith Revisited*, *supra* note 2, at 727–28 (same); Summers, *The General Duty*, *supra* note 5, at 824–25 (same); Van Alstine, *supra* note 9, at 1247 (same).

250. Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 812 (1958); Patterson, *supra* note 2, at 380; *see also* Burton, *U.C.C.*, *supra* note 25, at 1539 ("'Honesty' is supposed to be a subjective standard . . . ."); Diamond & Foss, *supra* note 20, at 599 ("[T]he phrase requires defendant to demonstrate a 'white heart' even if his conduct

While "observance of reasonable commercial standards," which is perceived as an objective standard,[251] appeared in the 1950 draft of the UCC alongside "honesty," it was ultimately abandoned.[252] A two-pronged test, combining honesty and observance of commercial standards, was nonetheless employed in a limited context. It applied only to merchants in sales transactions,[253] and only to the specific uses of the term "good faith" in Article 2,[254] not to the general duty of good faith in performing and enforcing contracts under section 1-304.[255]

The two-pronged test was gradually incorporated in other sections,[256] and, following academic pleas,[257] found its way to the generally applicable definition of good faith in section 1-201.[258] Thus, the UCC's general definition of good faith currently combines subjective honesty and objective reasonableness.[259] Even before the modification, it was argued that the jurisprudential essence of good faith in the UCC is "the linking of the good faith obligation of performance with reasonable commercial standards."[260] Now this general linkage is unambiguous. But while the modification has broadened the array of prohibited conduct under the UCC, it still leaves out

---

reflects an 'empty head.'"); Van Alstine, *supra* note 9, at 1247 (explaining that good faith is "a standard historically understood as a 'subjective' one").

251. *See* Burton, *U.C.C.*, *supra* note 25, at 1539 (explaining that this component is objective); Patterson, *supra* note 2, at 380 (same).

252. *See* Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 673–74 (discussing this change of heart); Mooney, *supra* note 5, at 245 (same); Patterson, *supra* note 2, at 381–82 (same); Summers, *Good Faith*, *supra* note 59, at 207–10 (same).

253. The two-pronged test is currently codified at U.C.C. § 2-201(b)(20). *See* Burton, *U.C.C.*, *supra* note 25, at 1539 (discussing the original version); Burton, *Article 2*, *supra* note 25, at 2 n.6, 17, 26 (same); Farnsworth, *UNIDROIT*, *supra* note 8, at 52 (same); Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 666–67 (same); Litvinoff, *supra* note 8, at 1656 (same); Patterson, *supra* note 2, at 380, 382 (same); Van Alstine, *supra* note 9, at 1247 (same).

254. *See* Burton, *Article 2*, *supra* note 25, at 26 (explaining the limitation); Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 675 (same); Summers, *Good Faith*, *supra* note 59, at 212 (same).

255. The view that the definition in U.C.C. § 2-103 applied to any application of the § 1-304 duty to transactions governed by Article 2 was not common. Burton, *Article 2*, *supra* note 25, at 26–27; Summers, *Good Faith*, *supra* note 59, at 212–13.

256. *See* U.C.C. § 1-201 cmt. 20; Van Alstine, *supra* note 9, at 1244–50 (describing this development).

257. *See, e.g.*, Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 671–72, 678–79 (explaining that good faith must have an objective component).

258. *See* Houh, *Empty Vessel*, *supra* note 16, at 1 (describing the current version of good faith in the UCC).

259. Summers, *Good Faith Revisited*, *supra* note 2, at 728; *see also* Summers, *Good Faith*, *supra* note 59, at 208 (explaining that honesty in fact is a subjective test, whereas compliance with reasonable commercial standards is an objective test).

260. Mooney, *supra* note 5, at 248 (quoting Mentschikoff, *supra* note 15, at 168) (internal quotation marks omitted).

some judicially recognized forms of bad faith that do not involve dishonesty or negligence.[261]

2. The Role of Community Standards

The concept of reasonableness may have different normative and positive definitions, as we explained elsewhere.[262] At least in the context of tort law, the meaning of reasonableness is still disputed.[263] However, the concept of "reasonable commercial standards" in the UCC definition of good faith has been widely perceived as closely associated with community standards. The official comment to section 1-304 provides, with no reference to reasonable commercial standards, that the principle of good faith is "further implemented by Section 1-303 on course of dealing, course of performance, and usage of trade."[264] But there are also clearer external indicia for the predominance of the above perception.

First, the ABA Committee on the Proposed Commercial Code observed in 1950 that "the phrase 'observance of reasonable commercial standards' carries with it the implication of usages, customs or practices."[265] The Committee actually opposed the "observance of reasonable commercial standards" test by pointing out the weaknesses of a common-practice test, thereby associating the two. It opined that proving usage or custom is very "litigious,"[266] and that requiring compliance with usage, customs, and practices existing at a given time might perpetuate these practices, impairing the flexibility necessary in commercial activities.[267] There is no reason to believe that the meaning of the phrase was changed when it was reintroduced into the general definition of good faith in section 1-201.

Second, the understanding that good faith under the UCC is associated with common practice may derive from the doctrine's intellectual origin, namely the German Civil Code. The latter consists of two general references to good faith. Section 157 provides that contracts are to be interpreted as required by good faith,[268] and section 242 provides that contract parties

---

261. *See* Summers, *Good Faith*, *supra* note 59, at 210–12 (contending that the UCC's definition of prohibited conduct is not sufficiently inclusive); Summers, *Conceptualization*, *supra* note 4, at 128 (same).

262. Miller & Perry, *supra* note 1, *passim* (discussing various definitions of reasonableness).

263. *Id.*

264. U.C.C. § 1-304 cmt. 1 (2011). Of course, section 1-303 has applied in all cases even before section 1-201 was amended to include "reasonable commercial standards." *See* Burton, *Article 2*, *supra* note 25, at 18, 27.

265. Walter D. Malcolm, *The Proposed Commercial Code*, 6 BUS. LAW. 113, 128 (1951); *see also* Summers, *Good Faith*, *supra* note 59, at 209 (citing Malcolm, *supra*).

266. Malcolm, *supra* note 265, at 128; Summers, *Good Faith*, *supra* note 59, at 209.

267. Malcolm, *supra* note 265, at 128; Summers, *Good Faith*, *supra* note 59, at 209.

268. BÜRGERLICHES GESETZBUCH [BGB] [Civil Code], Aug. 18, 1896, § 157 (Ger.) ("Verträge sind so auszulegen, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.").

have a duty to perform according to the requirements of good faith.[269] Both sections stipulate that the concept of good faith must be applied by "taking customary practice into consideration."[270] In fact, customary practice is the only source that the German Civil Code explicitly invites those applying the concept of good faith to consider.

Third, case law provides a plethora of validations for the linkage between "reasonable commercial standards" and common practice.[271] In many cases, failure to prove the other party's deviation from a common practice undermines an allegation of bad-faith performance.[272] For example, in *Tom-Lin Enterprises v. Sunoco, Inc.*, the plaintiffs operated gasoline service stations, selling the defendant's gasoline to the public.[273] They alleged that, at a certain point, the defendant started charging them excessively high prices for its gasoline under an open price term.[274] The court held that, under the UCC, a price is said to be fixed in good faith only if it is set in accordance with reasonable commercial standards of fair dealing in the trade.[275] This means the plaintiffs should have provided evidence "of the manner in which other marketers of gasoline in [the area] set their prices."[276] However, they did not provide any admissible proof.[277] Similarly, in *Richard Short Oil Co. v. Texaco, Inc.*, already discussed above, the court concluded that the plaintiff failed to prove a violation of the duty of good faith under the UCC because it "did not produce evidence of the pricing or rebate practices of other oil companies . . . nor did [it] present evidence of retailer-wholesaler price margins, price rebates, or ceilings on price

269. *Id.* § 242 ("Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.").

270. *Id.* §§ 157, 242.

271. *See, e.g.*, Story v. City of Bozeman, 791 P.2d 767, 775 (Mont. 1990) (equating "reasonable commercial standards" with "accepted commercial practices").

272. In addition to the examples discussed below see, e.g., *Johnson & Johnson Prods., Inc. v. Dal Int'l Trading Co.*, 798 F.2d 100, 106 n.4 (3d Cir. 1986) ("Since appellees tendered no evidence of trade practice, [the reasonable commercial standards] portion of the definition of good faith does not aid them."), *E. Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 979 (5th Cir. 1976) ("There was no evidence at trial concerning the 'reasonable standards of fair dealing' in the commercial aviation industry. We, therefore, cannot determine whether Eastern's conduct failed to satisfy contemporary standards of commercial good faith."), and *Zapatha v. Dairy Mart, Inc.*, 408 N.E.2d 1370, 1378 (Mass. 1980) ("There was no evidence that Dairy Mart failed to observe reasonable commercial standards of fair dealing in the trade.").

273. Tom-Lin Enters. v. Sunoco, Inc., 349 F.3d 277, 278–79, 283–84 (6th Cir. 2003).

274. *Id.* at 278.

275. *Id.* at 282 ("For a price to be fixed in good faith, the price must be set pursuant to reasonable commercial standards of fair dealing in the trade. . . . In order for Plaintiffs to meet their burden . . . [they] must prove, with respect to pricing, that [defendant] violated reasonable commercial standards of fair dealing in the gasoline marketing industry."); *see also id.* at 281 ("[A] merchant-seller lacks good faith in fixing a price pursuant to a contract with an open price term, [only if] the price was not fixed in a commercially reasonable manner.").

276. *Id.* at 282.

277. *Id.* at 283.

rebates."[278] In *Cargill Global Trading v. Applied Development Co.*, the court held that, had the defendant violated an industry standard, it would have been "much more likely that it had acted in bad faith" under the UCC definition.[279] However, the plaintiff failed to prove the existence of such an industry standard, and therefore there was no violation of the duty of good faith.[280]

In some cases, proof that one complied with common practice serves to refute the allegation that one acted in bad faith.[281] For example, in *Eastern Air Lines, Inc. v. Gulf Oil Corp.*, also discussed above, the court construed "reasonable commercial standards of fair dealing" as courses of performance, courses of dealing, and usages of trade.[282] It then found that "fuel freighting" was an established industry practice,[283] which had become part of the established courses of performance and dealing between the parties,[284] and concluded that there was no breach of the duty of good faith.[285]

Of course, there are cases in which proof of deviation from a common practice substantiates a claim of bad faith. For example, in *IBP, Inc. v. Hady Enterprises, Inc.*, the plaintiff sold beef products to the defendant under purchase orders indicating that the products would be exported to Russia.[286] With the intention of obtaining a higher price, the defendant re-bagged and re-labeled the products to present them as if they complied with strict Egyptian requirements, and exported them to Egypt.[287] Egyptian authorities discovered this and banned the plaintiff from the Egyptian market.[288] The plaintiff brought an action for breach of contract. The court found that in the meat-product trade, when a purchase order specifies a particular country of destination, the recipient cannot divert the product to another

278. Richard Short Oil Co. v. Texaco, Inc., 799 F.2d 415, 422–23 (8th Cir. 1986).

279. Cargill Global Trading v. Applied Dev. Co., 706 F. Supp. 2d 563, 581 (D.N.J. 2010).

280. *Id.* at 581–82.

281. In addition to the example discussed below, see, e.g., *Mathis v. Exxon Corp.*, 302 F.3d 448, 454 (5th Cir. 2002) (discussing the defendant's argument that it satisfied the "commercial reasonableness" meaning of good faith by charging the plaintiffs a price within the range of its competitors' prices), and *Allapattah Servs., Inc. v. Exxon Corp.*, 61 F. Supp. 2d 1308, 1323–24 (S.D. Fla. 1999) ("Departures from customary usages and commercial practice, flushed out through expert testimony, strongly indicate that the merchant's conduct is [commercially] unreasonable. . . . [Defendant showed its actions were] consistent with fair dealing in the trade based on custom or usage." (citation omitted)).

282. E. Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 436 (S.D. Fla. 1975) (quoting U.C.C. §§ 2-103(1)(b), 2-306 cmt. 2 (1965)).

283. *Id.* at 436–37.

284. *Id.* at 437.

285. *Id.*; *see also* Burton, *Article 2*, *supra* note 25, at 17–18 (discussing this component of the decision).

286. IBP, Inc. v. Hady Enters., 267 F. Supp. 2d 1148, 1155–56 (N.D. Fla. 2002).

287. *Id.* at 1156–57.

288. *Id.* at 1158–59.

destination without making sure that the product meets the relevant requirements at the new destination.[289] The court concluded therefore that, by not verifying that Egypt accepted products made for the Russian market, the defendant breached the contract as determined by the usage of trade, thereby violating the UCC duty of good faith.[290]

Finally, the linkage between "reasonable commercial standards" and common practice has been accepted in academic literature. Statements to this effect already appear in some of the earliest commentaries on good-faith performance under the UCC. For instance, the late Allan Farnsworth observed in 1963 that "to the extent that the test is objective . . . commercial practices become vital in establishing the standards of good faith."[291] Due to the fact that, at that time, the objective standard had a limited application, the role of commercial practice was similarly limited.[292] Still, another author opined that "[t]he Code concept of good faith commercial dealing is inextricably linked with commercial customs and usages."[293] More recently, Farnsworth explained the practical implications of the association between reasonable commercial standards and common practice. In his view, under the rubric of "reasonable commercial standards," courts can consider testimonies of witnesses "familiar with the behavior of others in the trade."[294] He further explained that although such testimony "may be similar to that used to establish trade usage," the two differ because testimony about the standard of fair dealing "need not be limited to the period before the making of the contract and may extend up to the time of the claimed breach of the duty of good faith."[295]

II. CHALLENGING THE COMMON DENOMINATOR

A. COMMUNITY STANDARDS ARE DERIVED FROM PERCEPTIONS

In Part I, we showed that all major accounts of good faith share a common denominator; all rely to some extent on the concept of community standards. Further on, we identified two forms of community standards relevant to the determination of good faith: those based on common practice, and those based on a common view of morality.[296] Neither courts nor commentators have been entirely clear which of these distinct forms underlies their specific theories of good faith. In this Part, we will show that this choice is largely irrelevant. Whether based on common practice or on a

289. *Id.* at 1159.
290. *Id.*
291. Farnsworth, *Good Faith Under the UCC*, *supra* note 9, at 677.
292. *Id.*
293. Mooney, *supra* note 5, at 247.
294. Farnsworth, Address, *supra* note 84.
295. *Id.*
296. *See supra* Part I.A.2.

common view of morality, every theory of good faith that is based on the idea of community standards suffers from a serious flaw. This common denominator is unsound and cannot be used in practice.

The first form of community standards—that based on common practice—derives its root from actual behavior in the relevant industry. A good example can be found in *Eastern Air Lines, Inc. v. Gulf Oil Corp.*[297] Recall that in *Eastern Air Lines*, the plaintiffs alleged that the defendant–airline acted in bad faith by engaging in a practice known as fuel freighting. The court looked at evidence of the actual practice in commercial aviation and established that fuel freighting was in fact a standard industry practice. On the basis of this evidence, the court concluded that the defendant had acted in good faith.

Community standards based on a common view of morality do not derive from evidence of past behavior, but from moral beliefs held by members of the relevant community, whether that community be defined as the industry or as the society in which the contract was formed. Such an approach is suggested by section 205 of the *Restatement (Second) of Contracts*, which states that "[g]ood faith performance . . . excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness."[298] It is not entirely clear whether the drafters of the Restatement intended to endorse a moral-based approach; however, we cannot entirely discount this possibility, especially given that the terms decency, fairness, and reasonableness are all heavily laden with moral connotations.

In practice, these distinct forms of community standards are proved in court using similar methods. In both cases, courts rely on evidence of perceptions. This is clear in the case of the common view of morality. Here, the community standard is based on the community members' perceptions of what is moral—what is fair, decent, and reasonable. While members of the community may not be asked to testify directly, the triers of fact must, implicitly or explicitly, base their judgments on their knowledge of those perceptions.

The case of common practice requires further explanation. In principle, common practice is based on past behavior. However, when applying such a community standard, it is not sufficient for the court to simply look at a set of past occurrences. No two past events are identical, and no past event will ever be identical to any future one.[299] Common practice is the aggregate of a set of separate events that are distinct on many dimensions. At the very least, each occurred at a different date and time and

297. E. Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975).

298. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981).

299. *See* White, *supra* note 146, at 686 (explaining that the disruptions that underlie good-faith cases are "often unexpected and unusual, [so] it is yet more likely that these events are too infrequent to form a trade practice").

in an economy with different commodity prices and interest rates. Usually, the events may be distinguished on other grounds as well—the parties may have been different or the relationship may have changed, the contract terms may differ, or a war may have broken out in a remote corner of the globe. Whether these distinctions are relevant cannot be determined by simply looking into the past. To apply common practice, we must have a theory that tells us how to evaluate these differences.

The most valuable theories come from individuals with deep knowledge of the industry. This is true for two interrelated reasons. First, these individuals possess the relevant knowledge to appreciate the factual nuances. Their knowledge enables them to make an expert judgment as to the relevance of a war in Asia to the performance of a contract in America. Second, as industry experts, these individuals can provide the best evidence of what the parties may have intended at the time of formation. Karl Llewellyn, the principal drafter of the UCC, thought that commercial disputes should be resolved by reference to usage, as determined by past behavior. However, as a procedural method, he believed that one should combine experts' opinions to prove the existence of usage. Llewellyn envisioned the creation of a special tribunal of merchants who would judge claims of bad faith according to their understanding of the "usage of trade."[300]

Llewellyn's proposal for merchant tribunals to try commercial cases was never adopted. Nevertheless, experts play an important role in the contemporary process. Courts engaged in determining common practice rely on experts who testify as to their perception of common practice in the industry. The expert perception is formed, implicitly, by combining knowledge of past events with a theory that explains their relationship to each other and to the case at hand. Of course, there will often be many such experts, each of whom has a perception of common practice. Somehow, the court must have a theory of how to put the potentially different perceptions together.

So, in practice, a court seeking to adjudicate a claim of bad faith must ultimately base its decision on perceptions held by members of a group. If the court operates under a theory arising from common practice, the relevant perceptions are those of the common practice, and the group is a set of individuals highly familiar with the relevant industry. If the court operates under a theory arising from a common view of morality, the relevant perceptions are those of morality, and the group is the set of members of a community, whether that community is the industry or society at large. The only practical difference between these rival approaches is the

300. *See* Patterson, *supra* note 196, at 206–07 (discussing Llewellyn's vision); White, *supra* note 146, at 684–86 (presenting and criticizing Llewellyn's view).

identity of the individuals whose perceptions are relevant and the type of perceptions at issue.

The remainder of this Part focuses on this commonality between the common practice and the common view of morality. In what follows, we describe a formal model of the community standards used to adjudicate claims of bad faith. The model is general enough to include perceptions of common practice as well as perceptions of morality. We will then apply a theorem from social-choice theory that leads to a stark and limiting conclusion: an action by a contracting party must be determined to be in good faith as long as it is considered so by a single expert (in the case of common practice) or by a single member of the community (in the case of a common view of morality). This must be the case even if all other experts disagree. The result indicates that all existing theories of good faith are deeply flawed in resorting to either form of community standards.[301]

In Subpart B, we introduce the field of social-choice theory from which our formal model is drawn. In Subpart C, we introduce a formal model of good faith. Subpart D contains a discussion of the properties that a method seeking to derive the standard of good faith should satisfy. We conclude this Subpart with a theorem that states that only one such method—the nomination rule—satisfies all properties. The nomination rule is a very limiting view of good faith and is of little practical use. In Subpart E, we offer a simplified proof of this theorem.

B. A BRIEF INTRODUCTION TO SOCIAL CHOICE

Our argument is based on an idea from the theory of social choice similar in structure to the famous "General Possibility Theorem" for which Kenneth Arrow received the Nobel Prize in 1972.[302] We describe Arrow's famous result in this Subpart to give the reader some insight into the method we use. To understand the "General Possibility Theorem," consider the scenario in which we have a group of individuals, such as the people of England, and we wish to know what England prefers. We can, of course, describe the individual wants and desires of the great many people in that country, but an important question remains. How can we combine the individual preferences into a social preference—England's preference?

In the eighteenth century, a French philosopher known as the Marquis de Condorcet presented powerful arguments in favor of majoritarianism: England prefers to retain her colonies when the majority of her subjects

301. Others have criticized the use of community standards in contract law. *See* Bernstein, *supra* note 54, at 715 ("'[U]sages of trade' and 'commercial standards' . . . may not consistently exist, even in relatively close-knit merchant communities."). But our Article is the first to present a theoretical account of why these standards may not exist.

302. KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (2d ed. 1963). The "General Possibility Theorem" is commonly referred to as the Arrow Impossibility Theorem.

prefer to do so as well.[303] But Jean Charles de Borda, a rival of Condorcet, discovered that the majority rule can lead to a paradoxical result.[304] To illustrate this problem, commonly known as the "Condorcet Paradox," consider the following three beliefs that might have been held by people in England at the time of the American Revolution. According to the first belief, it is preferable to send the full force of the English army to stop the rebellion rather than to send a small expeditionary force with more limited odds of success. According to the second belief, it is preferable to send the small expeditionary force rather than to send no military force at all, letting the colonists secede unopposed. According to the third belief, it is preferable to send no military force at all rather than to send the entire English army. These beliefs are summarized in Table 1.

TABLE 1: THREE BELIEFS

Belief	First Option	Preferred To
1	Full Army	Small Force
2	Small Force	No Troops
3	No Troops	Full Army

An individual can subscribe to any one or two of these beliefs. For example, one might subscribe to the first two beliefs, motivated by a desire to use as much force as possible to stop the rebellion. We might label such a person a "hawk." Or one might adhere to the latter two beliefs, on the ground that something should be done to stop the rebellion, but that it would be too costly to send the entire army when it might be needed elsewhere in the empire. We might label such a person an "econ." Alternatively, one might subscribe to the first and third beliefs, perhaps because that person wants to avoid a military failure above all else.[305] We might label such a person a "dove." But while one can subscribe to one or two of the beliefs, one cannot adhere to all three at the same time.

303. For more on Marie Jean Antoine Nicolas Caritat, Marquis de Condorcet, and his method, see H.P. Young, *Condorcet's Theory of Voting*, 84 AM. POL. SCI. REV. 1231 (1988).

304. De Borda's discovery is often attributed to Condorcet. *See* LEO KATZ, WHY THE LAW IS SO PERVERSE 3–6 (2011) (discussing the paradox).

305. Sending no troops involves no risk of military failure. Sending the full army does involve some risk of military failure, but smaller than when only a small force is sent.

TABLE 2: HAWKS, ECONS, AND DOVES

	Hawks	Econs	Doves
First Priority	Full Army	Small Force	No Troops
Second Priority	Small Force	No Troops	Full Army
Third Priority	No Troops	Full Army	Small Force

The problem discovered by de Borda is that it is possible for all three beliefs to be supported by some majority of the population. In other words, the Condorcet Paradox shows that the majority rule does not create a well-defined social preference.[306] To understand the paradox, assume that the population is composed of three groups, each of which comprises exactly one-third of the population.[307] The first group is composed entirely of hawks, the second entirely of econs, and the third entirely of doves. Each group is composed of people with a consistent set of beliefs, but this leads to the paradoxical outcome in which each of the three beliefs is subscribed to by two-thirds of the population, and therefore by England. The paradox is illustrated in Table 3.

TABLE 3: THE CONDORCET PARADOX

Groups	Shared Preferences
Hawks & Doves	Prefer Full Army to Small Force
Hawks & Econs	Prefer Small Force to No Troops
Econs & Doves	Prefer No Troops to Full Army

If the majority rule does not work, what will? Arrow addressed this question using an axiomatic approach. He looked for axioms, or properties, that the social preference should satisfy. One property is that the social preference should be a valid preference—it should not create an illogical cycle, as in our example.[308] Another property stated that if everyone in England preferred one alternative to another, then England would prefer that alternative as well. A third property stated that when deciding between two alternatives—sending the full army and sending a limited force—the relative ranking of the two alternatives should not be affected by the existence of a fourth alternative (e.g., sending gift baskets to the Continental

306. For more on the Condorcet Paradox, see KATZ, *supra* note 304, at 3–6.

307. The assumption that each group comprises exactly one-third of the population is stronger than necessary. All that is needed for this result is that no group forms a majority.

308. The requirement that the social preference be a valid preference is often not stated as an axiom, but it is implicitly required by the model.

Congress in place of a military force). We are not concerned here with the specific content of Arrow's axioms. What is relevant is that they are simple natural properties that one should expect the social preference to satisfy. Using mathematical tools, Arrow showed that a social preference can satisfy all three properties if and only if it is a dictatorship: one person in England—perhaps George III—determines England's preference.[309] Arrow did not mean, however, to argue that dictatorship was the best form by which society could be organized—he opposed this form of government. Consequently, there is no reasonable method by which we can combine the preferences of the many into a single preference.[310]

Following Arrow's path, we use the axiomatic approach. We define a model of community standards of good faith and introduce several natural axioms that should be followed by the court. In the end we arrive at a stark result: any community standard that satisfies our axioms is necessarily flawed. But this is where the similarity to Arrow ends. The formal model (the problem of interest) involves the aggregation of a specific type of judgment (perceptions of good faith) and not of preferences.[311] The axioms (the properties that we study) are markedly different from those used by Arrow; they are more closely related to axioms introduced by Kenneth May in a different context.[312] Consequently, the formal result, the underlying reasoning, and the ascribed meaning are quite distinct. The theorem we describe neither implies nor follows from Arrow's theorem.[313]

C. THE FORMAL MODEL

We introduce a formal model of the community standards used to apply the duty of good-faith performance. Recall that both forms of community standards—those which derive from common practice and those which derive from a common view of morality—must ultimately be derived from perceptions held by members of a group. In the case of common practice, the perceptions are those of industry behavior, and the group consists of

309. This is intended as an example and not as an accurate description of England at the time of George III.

310. For more on Arrow, see KATZ, *supra* note 304, at 97–103.

311. *See* Lewis A. Kornhauser & Lawrence G. Sager, *Unpacking the Court*, 96 YALE L.J. 82, 84–88 (1986) (discussing the distinction between judgment aggregation and preference aggregation).

312. Kenneth O. May, *A Set of Independent Necessary and Sufficient Conditions for Simple Majority Decision*, 20 ECONOMETRICA 680 (1952). The "equal treatment" and "direction" axioms introduced in *infra* Part II.D are related to May's Condition II ("equality") and Condition IV ("positive responsiveness"). *Id.* at 681–82. Our "neutrality" axiom is not formally related to May's Condition III (also labeled "neutrality"), although both have a similar justification.

313. For the formal statement of the theorem, see Alan D. Miller, Essays on Law and Economics (Apr. 6, 2009) (unpublished Ph.D. dissertation, California Institute of Technology), *available at* http://thesis.library.caltech.edu/2283/1/Miller_Dissertation.pdf. The theorem was originally applied to community standards in the context of obscenity law. *Id.* For an application to tort law, see Miller & Perry, *supra* note 1, *passim*.

individuals with expert knowledge. In the case of a common view of morality, the perceptions are moral beliefs about good faith, and the relevant group is a community, perhaps from the industry or from broader society.

We begin by defining three sets relevant to our model—one of merchants, one of behaviors, and one of scenarios. The set of *merchants* is the simplest of these to understand. It is simply any group of individuals. While we use the term "merchant" in homage to Llewellyn, this set can consist of any other group, such as individual experts, industry insiders, or the entire population of Cleveland. The set of *behaviors* contains every possible action that may be taken by a contracting party. It includes performing the contract at the specified time, failing to perform the same contract, interfering with the other party's performance, or nominating one's competitor for the Nobel Peace Prize. Because it consists of every possible behavior, this set is very large.[314] The set of *scenarios* includes every relevant circumstance that the contracting party may have faced. A scenario may include, but is not limited to, the terms of the original contract, the circumstances under which it was made, and the events which have occurred since, such as changes in commodity and labor prices, the weather, and possibly significant geopolitical events.

A *perception* of good faith, in terms of our model, is a complete description of the behaviors deemed in good faith when taking into account the scenario—the relevant circumstances—in which the contracting party found itself. In other words, each perception associates each scenario with a set of behaviors. That is, when prices have risen and the city is facing a hurricane, a certain set of behaviors is considered to be in good faith. And when the weather is sunny but war has broken out near the Persian Gulf, another set of behaviors may be considered to be in good faith. These two sets of behaviors may be identical, they may overlap, or they may be entirely distinct. We place but one restriction on merchants' perceptions of good faith: it must always be possible for a contracting party to perform in good faith. This means that, for every scenario, each merchant must believe some nonempty set of behaviors to be in good faith. Beyond this simple condition to ensure that merchants' beliefs are sensible, we place no other restrictions on what a merchant is allowed to believe—after all, it is the merchants who determine the community standard, not the authors of this Article.[315]

---

314. Formally, we assume this set to be infinitely large ("uncountable" in the language of mathematics). To understand the implications of this modeling choice, see Miller, *supra* note 313, at 43.

315. Among other beliefs, we allow merchants to believe that compliance with the express terms of the contract is not necessarily in good faith. This is consistent with a large number of court opinions. *See* Dobbins, *supra* note 5, at 266 ("The view that a party can breach the implied covenant of good faith by exercising an express contractual right is justified by the argument that the duty of good faith enforces 'community standards of decency, fairness or

So, by now one may envision a set of merchants, each with an individual perception of good faith. The "common perception" in our model is itself a perception of good faith, derived somehow by combining the many perceptions held by the merchants. There are many possible methods by which the common perception may be derived from the merchants' perceptions.[316] We posit that the specific method is integral to a theory of community standards in the following sense[317]: the desirability of such a theory depends, implicitly, on the existence of at least one reasonable method to combine the merchants' perceptions.[318]

In the next Subpart, we introduce several axioms that any reasonable method used to combine perceptions of good faith must satisfy—whether grounded in common practice or in a common view of morality. In the end, we apply a theorem from social-choice theory to show that only one method, which we call the *nomination rule*, satisfies these axioms. According to this rule, a contracting party will be deemed to have acted in good faith whenever a single member of the community considers it so, regardless of the number of community members who disagree.[319] Just as Arrow did not defend dictatorship, we do not defend the nomination rule—it is deeply impractical and does not represent current practice. However, we are then led to the inevitable conclusion that no reasonable method of combining perceptions of good faith exists.

D. METHODS AND AXIOMS

To many people, the most obvious method of combining perceptions of good faith would be the *majority rule*, whereby a behavior is determined to be in good faith in a particular scenario when the majority believes it to be so.

---

reasonableness.'"); Van Alstine, *supra* note 9, at 1258 ("In this early flowering of the doctrine, courts properly understood that the doctrine retains significance even in the face of an express grant of discretion under the contract."). This view, however, is not uniform; some courts have found compliance with contract terms to be a defense against claims of bad faith. *See supra* note 57 and accompanying text.

316. The number of derivation methods we would need to analyze is infinite. This is because the set of behaviors is assumed to be infinite. However, even if the sets of behaviors and fact scenarios were both finite, the number of methods would be finite but mind-bogglingly large. Even if we consider the special case where there are three merchants, three behaviors, and only one fact scenario, the number of possible methods would vastly exceed the number of atoms in the observable universe. We would clearly not have enough paper to write them all down.

317. Karl Llewellyn himself was not concerned with the specific method by which these perceptions were to be combined. *See* Patterson, *supra* note 196, at 207 (discussing Llewellyn's view).

318. Of course, even in the absence of a reasonable method, the merchant jury would generate results in specific cases; however, these results might be deemed arbitrary, like those generated by flipping a coin.

319. The term *nomination rule* is given a similar meaning in the context of group identification. Alan D. Miller, *Group Identification*, 63 GAMES & ECON. BEHAV. 188, 194 (2008).

In this context, the majority rule faces a problem analogous to the Condorcet Paradox. In the context of voting, the Condorcet Paradox teaches us that the majority rule may not create a well-defined preference. In our context, the majority rule may not create a well-defined common perception: it is possible that in some scenarios, no behavior will be deemed in good faith by a majority of people. This problem is illustrated in Figure 1.

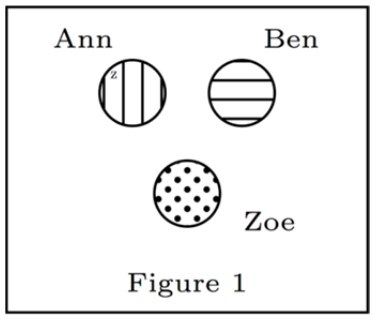

Figure 1

Figure 1 depicts three merchants' perceptions of good faith for a single scenario. Each of the three circles denotes the set of behaviors considered to be in good faith by one of the merchants. The circles do not overlap, so no behavior is considered to be in good faith by more than one merchant. Consequently, no behavior is considered to be in good faith by a majority in this scenario, and the majority rule fails—it violates our initial requirement that some behaviors that are in good faith must always exist.

The majority rule belongs to a wider class of methods known as *quota rules,* in which a behavior is determined to be in good faith in a particular scenario when a pre-set number of merchants (the *quota*) believe it to be so. The majority rule is the special case where the quota is slightly above half the number of merchants.[320] If the quota is greater than one, a quota rule will suffer from the same problem as the majority rule. It is possible that, for a particular scenario, no behavior will be considered in good faith by two people. Only if the quota is set at one is it guaranteed that some behaviors will be in good faith. We use the term *nomination rule* to discuss this special case because, when the quota equals one, the method is similar to a nomination process, in which any member of the group has the power to nominate.

Of course, one might object to this line of reasoning on the ground that this problem is not likely to occur in practice, theoretically possible though it might be.[321] Nonetheless, when the problem does occur, the method must

320. Because of this, the majority rule excludes the possibility that a tie will occur.

321. Such an objection is unlikely to be supported by evidence. How exactly can one tell how likely this problem is to occur? Of course, this lack of evidence also makes the objection rather hard to refute.

provide an answer. For this reason, one may suggest a compromise: a method formed by combining the majority rule with the nomination rule, which we term the *majority–nomination rule*. According to this method, the common perception is determined by the majority rule when it works—namely, when it leads to the result that some behaviors are determined to be in good faith for the scenario. When the majority rule fails—when, for the scenario in question, no behavior is considered to be in good faith by a majority—this method determines the common perception by use of the nomination rule. The majority–nomination rule is well defined and always leads to a valid *common perception*. The majority–nomination rule is a type of *variable-quota rule* where the quota changes so that some behaviors are in good faith for every scenario.[322]

However, the majority–nomination rule and other variable-quota rules suffer from a serious problem. A defendant may lose her case *because* all the merchants have become more sympathetic to defendants by adopting a more permissive view of good faith. Before we explain this problem, we must first define what we mean when we write that one perception of good faith is more *permissive* than another. For example, suppose we are presented with the following question: Was it reasonable to unilaterally modify a contract with two-days' notice upon news of a war erupting, followed by a sharp rise in oil prices? Here, permissive has a natural meaning: Ann is *more permissive* than Ben if she considers the modification to be in good faith while Ben does not.[323] This concept is clear when we are considering beliefs about individual behaviors under particular scenarios, but it may be harder to compare entire perceptions of good faith. After all, Ann may be more permissive than Ben for some behaviors, and Ben may be more permissive than Ann for other behaviors. In such a case, it may not be possible to compare Ann's perception with Ben's. However, a clear case exists in which objective comparisons can be made. Suppose that, for every scenario, whenever Ben considers a behavior to be in good faith, Ann considers that same behavior to be in good faith as well. In that case we may objectively say that Ann's perception is at least as permissive as Ben's, because there is no behavior and scenario for which Ben is more permissive than Ann.[324]

Having defined what we mean by permissiveness, we proceed by explaining the problem of the majority–nomination rule and other variable-quota rules. Recall Figure 1, in which each of the three circles denotes the behaviors deemed in good faith by one of the merchants. Because no

322. In the case of the majority–nomination rule, there are two such quotas: (1) half the number of merchants, and (2) one merchant. The rule uses the first quota unless this leads to the result that no behavior is in good faith. Otherwise the rule uses the second quota.

323. Similarly, we might say that Ann is as permissive as Ben if Ben is not more permissive than Ann.

324. If Ann's understanding is at least as permissive as Ben's, either their perceptions are identical or Ann's understanding is more permissive.

behavior is deemed in good faith by more than one merchant, the majority rule fails for this scenario, and the nomination rule must be applied. Consequently, all the behaviors in the three circles are determined to be in good faith, including behavior *z* that Ann considers to be in good faith.

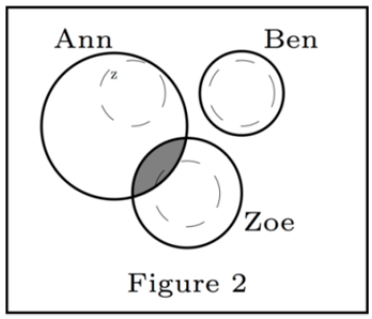

Figure 2

In Figure 2, each of the merchants has taken a more permissive view of what is considered to be in good faith. Every behavior that a merchant had considered to be in good faith is still considered so by that merchant, but some additional behaviors have been added to that group. This can be seen in Figure 2. The original circles, marked here with dashed lines, are now contained within the new enlarged sets. With this new set of beliefs, there are now behaviors that a majority considers to be in good faith (marked in gray). But this leads to a bizarre consequence under the majority–nomination rule and other variable-quota rules: only behaviors marked in gray are in good faith. The implication is that behavior *z* is no longer in good faith. This problem occurs with majority–nomination and all variable-quota rules.

We can formulate this objection to the majority–nomination rule as an axiom in the style of Arrow. We term this the *direction* axiom because it requires that the common perception must move in the same direction as the individual perceptions of good faith. Formally, direction requires that if each merchant becomes either (1) more permissive or (2) does not change, the common perception must either become more permissive or not change. Direction is a very natural axiom because it accords with the basic intuition that a defendant should not lose her case because the merchants have become more favorably disposed to her side.

The majority rule and other quota rules are not well defined—they may lead to an outcome where no behavior is in good faith. The majority–nomination rule and other variable-quota rules violate the direction axiom. What other alternatives exist for supporters of majoritarianism? One approach would be to declare a certain set of behaviors in good faith regardless of beliefs. For example, one might wish to define delivering flowers always to be in good faith. For all other behaviors, we might use the

majority rule. This method, the *flowers–majority rule*, is well defined, satisfies the direction axiom, and respects majoritarianism in all cases in which flowers are not delivered.

However, the flowers–majority rule suffers from problems of its own. A common perception that is derived through this method is not entirely derived from the merchants' perceptions of good faith in at least two senses. The first problem is that this method does not respect unanimity among the merchants. The flowers–majority rule determines flower delivery to be in good faith even when the merchants unanimously agree that this behavior is not.[325] The second problem is that flower delivery is treated differently from all other behaviors. The distinction between the delivery of flowers and the delivery of chocolate arises from the method by which the common perception is derived, and not from the merchants' perceptions.

Each of these problems can be turned into an axiom. The principle underlying the first problem is clear—the method by which the common perception is derived should reflect unanimous agreements of the merchants. To formulate this principle as an axiom, we must first define some terms. We write that the merchants have *homogeneous beliefs* if their perceptions of good faith are entirely identical. That is, there is no disagreement whatsoever over the status of a single behavior under any scenario. We do not claim that this case is very likely to occur. Contract disputes occur in a world of humans with human differences, and not in a world of clones.[326] But while this case may never occur in practice, it is nonetheless instructive. For if merchants are homogeneous—if there is a common belief, so that every merchant has an identical perception of good faith—then the common perception should simply be the common belief. Thus, our second axiom, which we term *homogeneity*, requires the method of deriving the common perception to preserve homogeneous beliefs. It requires that we get the "right" answer when faced with this special case.

The principle underlying the second problem is also clear: ex ante, all behaviors must be treated in the same way. Distinctions between behaviors found in the common perception must come from individual perceptions of good faith, and must not be an artifact of the method by which the common perception is derived. In principle, the labels that we attach to behaviors should not be relevant in determining whether they are in good faith; what should be relevant are simply the beliefs about these behaviors. Beliefs are expressed in terms of the scenarios under which such behaviors are in good faith. In this sense, two behaviors are equivalent if they are considered to be

325. In this sense the rule is bizarre. To preserve some semblance of the majority rule—so that some behaviors with minority support can be excluded from the set which is in good faith—we declare certain behaviors (delivering flowers) to be in good faith even though they have the support of no merchants at all.

326. This is not to say that contract disputes could not occur in a world of clones, but science fiction is beyond the scope of the present Article.

in good faith in exactly the same set of scenarios. To formalize this principle, we need to introduce another concept: "flipping" one's beliefs. Consider the following two behaviors[327]: (1) delivering forty tons of building materials to a construction site, and (2) requesting the contractor to send trucks to pick up the building materials from the warehouse. We say that Ann "flips" her beliefs about these two behaviors if she now considers delivering the materials to be in good faith in exactly the scenarios in which she previously considered requesting trucks to be in good faith, and if Ann now considers requesting trucks to be in good faith in the scenarios in which she previously considered delivering the materials to be in good faith. Suppose that every merchant flips his or her beliefs about these two behaviors. Our third axiom, *neutrality*, requires the common perception to flip its beliefs as well. The common perception must now consider delivering the materials to be in good faith exactly when requesting trucks had been in good faith before, and vice versa.

To understand why the flowers–majority rule violates neutrality, suppose that only Ann considers delivering flowers to be in good faith in a particular scenario, and that only Ben considers delivering chocolate to be in good faith in that scenario. Under the flowers–majority rule, delivering flowers is in good faith, and delivering chocolate is not.[328] Now the beliefs about these two behaviors flip. Ben (and only Ben) considers delivering flowers to be in good faith, while Ann (and only Ann) considers delivering chocolate to be in good faith.[329] In this case, the neutrality axiom requires that the common perception flip. But under the flowers–majority rule, delivering flowers is still in good faith, and delivering chocolate is not. In other words, the common perception remains the same, and does not flip, in violation of the neutrality axiom.

Some might object to the homogeneity and neutrality axioms on the ground that behaviors are in many ways concrete. The difference between delivering flowers and delivering chocolate, or between delivering materials and requesting trucks, is more than the difference in the labels and beliefs that are attached to them. The different behaviors correspond to different changes in the physical world. Consequently, one might argue that the common perception should reflect this physical reality. Along these lines, one might wish to determine the common perception according to a moral philosophy that takes the physical reality into account, independent of the

327. The axiom is defined more generally so that we can consider sets of behaviors of the same size.

328. Other behaviors can be in good faith or in bad faith, depending on other individuals' perceptions.

329. Because other individuals did not believe delivering flowers was in good faith, none considers delivering chocolate to be in good faith following the flip. Similarly, because other individuals did not believe delivering chocolate was in good faith, none considers delivering flowers to be in good faith now.

beliefs held by the merchants.[330] Such a view specifies a particular method of deriving the common perception, one that ignores the merchants' beliefs and instead incorporates a pre-selected perception of good faith determined strictly by the moral philosophy. A method of this type would be neither homogeneous nor neutral.

We contend that such a method of determining the common perception would violate the entire spirit of the enterprise. For if it is the moral philosophy that determines whether a behavior is in good faith, the "tribunal of merchants" is irrelevant.[331] The common perception would be an unnecessary legal fiction, unconnected with the community. Had courts intended such a procedure to be followed, they would merely have described the moral philosophy by which cases should be adjudicated.[332] Llewellyn would not have bothered to describe his conception of a merchants' tribunal. So it is clear that we can eliminate this special case from consideration and conclude that homogeneity and neutrality are necessary characteristics of a method for deriving the common perception.[333]

Another method through which the common perception may be derived would be one that pre-selects a group of merchants—call these the "elders"—and defines a behavior as being in good faith in a given scenario when one or more of the elders does as well. We will call these methods the *elders rules*. The *dictatorship rule* is a special case of an elders rule in which there is precisely one elder. The previously described nomination rule is also an elders rule in which every individual is an elder.[334] Elders rules satisfy direction, homogeneity, and neutrality.

However, a natural objection exists to all elders rules other than the nomination rule: the views of some merchants (the elders) are privileged over those of others. This objection also applies to more complicated methods that satisfy the three axioms; for example, if a behavior is defined as being in good faith in a particular scenario when it is considered so by any of the elders or by a majority of the merchants.[335] This objection can also be formulated as an axiom that requires the method to give equal weight to all merchants in the tribunal. To understand this axiom, suppose that Ann and Ben trade their perceptions, so that Ann adopts Ben's perception of good

330. Or in which the community standard is to be determined independent of the beliefs of any other group or any empirical data.

331. This would be similar to a country that allows voting but accords no weight to the outcome. However, this seems to be uncommon in practice; most dictatorial regimes care at least about the preferences of the dictator.

332. *See infra* notes 343–44 and accompanying text (discussing normative definitions of good faith).

333. This is not the only case for violating homogeneity—only the most compelling.

334. The nomination rule is the only elders rule that is also a quota rule.

335. This is different from the above-mentioned elders rules only if the elders are a minority. If the elders are a majority, then any majority will necessarily contain at least one elder.

faith, and Ben adopts Ann's old perception. In this case the beliefs of the merchants have not changed, but only the identities of the specific merchants holding them. Our fourth axiom, *equal treatment*, requires that the common perception must not change. The identities are irrelevant—only actual beliefs matter.[336] In Figure 3, Ben's new perception (on the right) is identical to Ann's old perception (on the left), and Ann's new perception is identical to Ben's old perception. The equal-treatment axiom requires that the common perception not change.

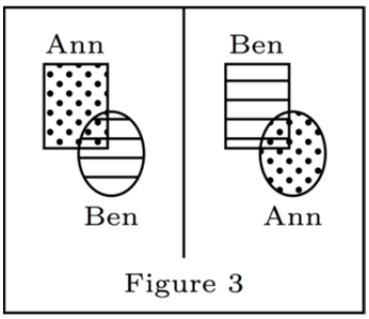

Figure 3

The equal-treatment axiom would be less compelling if we had an ex ante reason to privilege the views of some merchants over those of others. Clearly, one can think of reasons to accord more weight to certain merchants, but to do so in this case would be contrary to the spirit of the enterprise. All merchants in Llewellyn's hypothetical tribunal are equal; they are chosen on the basis of their (presumably similar) levels of experience. As a result, any distinction between them must be made on the basis of their perceptions, not their identities.[337]

We have introduced four axioms that are necessary characteristics of any reasonable method for deriving the common perception from individual perceptions of good faith. Out of an infinite number of possible methods, we have considered only a few, such as the majority–nomination rule, the flowers–majority rule, and the elders rules. A theorem from the economic field of social choice enables us to make a claim about all possible

336. The elders rule can be achieved by redefining the set of merchants to include only the elders. Because we can redefine the set of merchants to include only individuals to whose perceptions we wish to give some weight, the real restriction of the equal treatment axiom is that we cannot give more weight to one merchant over another while giving positive weight to both.

337. One can comprehend Llewellyn as implicitly distinguishing two classes of individuals: (1) a set of experts (the merchants), whose views are to be considered on an equal basis, and (2) a set of non-experts (everyone else), whose views are wholly ignored. This is not inconsistent with our theory. Recall that the model begins with a set of merchants from whose perceptions the common perception is to be derived. If one were to believe that all individuals' perceptions should be considered on an equal basis, the set of merchants could be defined to include the entire society.

methods, not merely the few we have discussed. The theorem states that only one method satisfies the four axioms.[338] This method is the nomination rule, under which a behavior is determined to be in good faith in a given scenario whenever one merchant or more believe it to be in good faith.

The nomination rule is not particularly desirable: it is an extremely permissive perception of good faith that would permit any behavior considered acceptable by a minority, no matter how small.[339] We would prefer to find another method that satisfies the four axioms. However, out of the infinite set of possible methods, it turns out that none exists. The nomination rule is the sole method for deriving the common perception from the merchants' perceptions of good faith that satisfies direction, homogeneity, neutrality, and equal treatment. We offer a simple proof of this claim in the next section.

E. A SIMPLE EXPLANATION OF THE PROOF

That the nomination rule satisfies the four axioms is quite easy to verify. It is less trivial to show that any method that satisfies the four axioms must necessarily be the nomination rule. We provide a simplified proof for the special case where there are three individuals and exactly one scenario.[340] Recall that the nomination rule defines a behavior as being in good faith when one merchant or more consider it so.

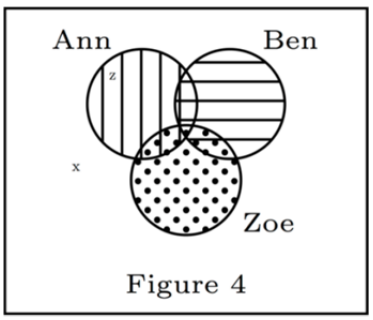

Figure 4

338. While only one method satisfies the four axioms, many methods satisfy a subset of the axioms. This highlights another feature of the axiomatic approach. Methods can be classified according to the properties that they satisfy. For example, while the majority–nomination and other variable-quota rules violate the direction axiom, one can easily verify that these methods satisfy the other three axioms—homogeneity, neutrality, and equal treatment. Similarly, the flowers–majority rule violates homogeneity and neutrality but satisfies direction and equal treatment. To the extent that one might find some axioms more compelling than others, this approach allows us to classify rules according to the properties they possess.

339. Of course, if the relevant set of individuals is very small, the theorem can be used to defend the nomination rule.

340. A more general proof is given in Miller, *supra* note 319, at 45–46.

Step One. We first show that any behavior that is not considered to be in good faith by even a single merchant cannot be deemed in good faith according to the common perception. We begin with three merchants, Ann, Ben, and Zoe, each of whom has a perception of good faith. We assume that at least one behavior is not considered to be in good faith by any merchant. These perceptions are depicted in Figure 4. Each of the three ovals denotes the set of behaviors considered to be in good faith by one of the merchants. Behavior *x* is not considered to be in good faith by any merchant.

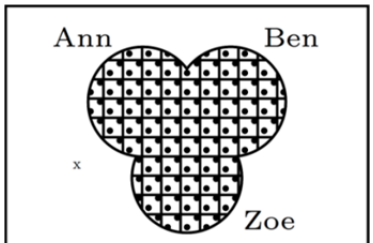

Figure 5

Now, suppose all three merchants become more permissive in a very specific way. Each merchant now considers a behavior to be in good faith if any of the three merchants had previously considered that behavior to be in good faith. That is, after this change, Ann considers a behavior to be in good faith if she had previously considered it to be in good faith, or if Ben or Zoe had previously considered it to be in good faith. These new perceptions are depicted in Figure 5. Note that now the three merchants have become perfectly homogeneous—their three perceptions are completely identical.

We wish to make two important observations. First, because all merchants share an identical perception of good faith, the homogeneity axiom implies that this shared perception is the common perception. Consequently, we know that, in this latter case, the common perception defines a behavior as not being in good faith when none of the merchants believes it so. Because no merchant believes that behavior *x* is in good faith, the common perception must also not consider it in good faith.

Second, because the merchants have become more permissive—they have taken a broader view of which behaviors are in good faith, the direction axiom implies that the common perception must also become more permissive. Every behavior that was in good faith before the change in beliefs (depicted in Figure 4) must therefore be in good faith after the changes (depicted in Figure 5). This directly implies that every behavior that was not in good faith after the change in beliefs (Figure 5) must also not have been in good faith before it.

By putting these two observations together, we can conclude that behavior *x* must not have been in good faith by the common perception, as derived from the initial beliefs (Figure 4). So the lesson here is clear: a behavior that is not considered to be in good faith by even a single merchant must not be in good faith according to the common perception.

Step Two. It still remains to be shown that any behavior that is considered to be in good faith by one merchant or more cannot be considered in bad faith by the common perception. The remainder of the proof is more complicated, so we need to introduce a special case that we will use as a reference: the case of complete disagreement. Suppose that Ann, Ben, and Zoe disagree completely, so that no two of the three agree that even a single behavior is in good faith. Suppose further that each of them believes an equal proportion of possible behaviors to be in good faith. This is the case that was depicted in Figure 1. Note that none of the circles overlap (indicating complete disagreement) and that each of the circles is of the same size (indicating that an equal proportion of possible behaviors is deemed in good faith by each merchant).

The equal treatment axiom implies that we can make no ex ante distinction between the merchants. The neutrality axiom implies that we can make no ex ante distinction between the three sets. As a result, every behavior considered to be in good faith by one of the merchants (and therefore contained in one of the circles) must be treated in the same manner. There follows two possible alternatives: either all such behaviors must be in good faith according to the common perception, or else none of these behaviors is in good faith.

We maintain that only the former alternative is possible: all such behaviors must be considered to be in good faith. To see why this must be the case, let us assume the opposite—that none of these behaviors is in good faith. The remaining possible behaviors (the area outside all circles) are considered to be in good faith by no merchants. As we have previously seen in step one, this implies that none of these behaviors are in good faith according to the common perception either. As a result, no behavior will be in good faith. However, this contradicts our prior assumption that it must always be possible to behave in good faith, so this cannot be right. Consequently, it must be the case that, in this special case of complete disagreement, a behavior is considered to be in good faith by the common perception when it is considered so by one of the three merchants.

Step Three. Let us return, then, to the perceptions of the merchants, as shown in Figure 4.[341] We need to show that a behavior considered to be in good faith by at least one of the three merchants is necessarily in good faith. In Figure 4, the behavior marked with a *z* is considered to be in good faith

341. It need not be the case, of course, that some behaviors will be considered to be in good faith by none, but it will not make a difference in our example.

by Ann, but not by Ben or Zoe. We will show that the common perception also considers behavior *z* to be in good faith.

Suppose now, that all three of the merchants' perceptions change, satisfying four conditions: (1) no two of the three merchants agree that a single behavior is in good faith; (2) for each merchant, the set of behaviors that is in good faith is an equal proportion of the whole; (3) Ann still considers behavior *z* to be in good faith; and (4) each merchant becomes stricter, so that each takes a narrower view of the set of behaviors that is in good faith. No matter what the merchants' initial perceptions are, it will always be possible to find a new set of perceptions that satisfies these four conditions.

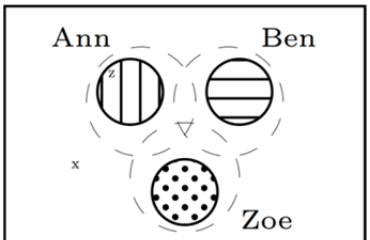

Figure 6

In Figure 6, the merchants' new perceptions are depicted with circles, and the merchants' initial perceptions (as shown in Figure 4) are depicted with dashed lines. None of the circles overlap; this reflects the first condition—that no two merchants agree that a single behavior is in good faith. Also, each of the three circles is of the same size; this reflects the second condition—that each of the merchants' sets is of the same size. As a result, we are at the special case of complete disagreement, and it follows from step two that every behavior considered to be in good faith by at least one merchant—that is, every behavior in one of these circles—must be in good faith.

We note two additional implications of Figure 6. First, behavior *z* is in Ann's circle; this reflects the third condition—that Ann continues to consider behavior *z* to be in good faith. Because (1) every behavior in the circles is in good faith and (2) behavior *z* is in one of the circles, behavior *z* must now be in good faith. Second, the circles are entirely contained within the dashed lines; this reflects the fourth condition—that each of the merchants' perceptions has become stricter. This implies that the original perceptions are less strict than the new perceptions. Consequently, the direction axiom implies that every behavior that is now considered to be in good faith (when derived from the new perceptions, as depicted in Figure 6) must have been in good faith to begin with (when derived from the original perceptions, as depicted in Figure 4.)

Together, these two implications lead to a third: because behavior *z* is now in good faith, this behavior must have been considered in good faith at the start. This is sufficient to complete this step—every behavior considered to be in good faith by at least one merchant must be in good faith according to the common perception. By combining this result with that of step one, we may conclude that, for any method satisfying the four axioms, a behavior is in good faith if and only if one merchant or more consider it so. This is precisely the nomination rule. Given the unlikelihood of consensus,[342] the fact that every merchant can veto a finding of bad faith renders the leading theories of good-faith performance fundamentally deficient.

CONCLUSION

This Article unveiled and challenged the common denominator of all major accounts of the supereminent duty of good-faith performance. The two components are groundbreaking on different levels. Part I showed, for the very first time in legal literature, that regardless of the specific definition of good faith we may choose to endorse, courts might end up resorting to community standards for guidance. These may be reflective of what people actually do (common practice) or what they believe ought to be done under the circumstances (common view of morality). Part II showed that the resort to community standards suffers from an inherent flaw. Regardless of whether community standards are based on common practice or on a common view of morality, they must ultimately be derived, according to some method, from a set of individual perceptions. By applying a theorem from the economic field of social choice, analogous to Kenneth Arrow's famous "General Possibility Theorem," we have shown that no defensible derivation method can exist.

What are the practical legal implications of this harsh conclusion? If courts should not employ community standards in determining whether a particular conduct violates the duty of good faith, how should they apply this doctrine? One may contemplate several possible answers. First, courts may adopt a purely subjective meaning of good faith, thereby making "objective" community standards irrelevant. This proposition is flawed for at least two reasons. To begin with, it throws the baby out with the bath water. The theoretical deficiency of community standards cannot in itself justify exclusion of all objective criteria. The objective component of good faith can be normative, possibly akin to the economic or equal-freedom

342. *See, e.g.*, Bernstein, *supra* note 54, at 715 (explaining that the debates surrounding trade associations' efforts to codify industry customs imply no "widespread agreement among merchants as to either the meaning of common terms of trade or the content of many basic commercial practices" and that "customs relating to important aspects of transactions were left uncodified because consensus could not be achieved"); White, *supra* note 146, at 686 (explaining that "competing experts are unlikely to agree on [the] terms or application [of common practice]").

definitions of the reasonable person in negligence law. Perhaps even more importantly, the distinction between subjective and objective criteria is hazy. Given the obvious evidentiary difficulties in ascertaining bad motive or dishonesty, courts applying a subjective test might ultimately rely on objective tests and guidelines.

Second, courts may revert to a strict textualist approach to contract interpretation, whereby the express terms of the contract reflect the totality of the parties' agreement, rendering contrary expectations irrelevant. Under this view, contextual details like community standards may become redundant. However, this proposition also seems like an overcorrection. By reverting to a textualist approach, we renounce not only community standards, but also other external circumstances pertaining to contract interpretation, like external evidence of actual intentions, prior course of dealing, or course of performance. In fact, as we noted in the introduction, a fervent retreat to strict textualism would trivialize the very doctrine of good-faith performance.

Third, courts and legislatures may simply reject community standards as a gauge for good-faith performance, but retain other types of contextual evidence, like course of dealing. Finally, the empirical tests for "decency, fairness, and reasonableness"—common morality or common practice—can be replaced with a normative test. The latter requires compliance with a particular normative ethical commitment, such as welfare maximization[343] or the golden rule,[344] as opposed to empirically based community standards.

343. *See* Mark P. Gergen, *A Defense of Judicial Reconstruction of Contracts*, 71 IND. L.J. 45, 78 (1995) ("In a fair number of cases, courts use the doctrine of good faith to . . . prevent a party from enriching himself by acting or threatening to act in a way that would impose a significantly greater loss on the other party.").

344. *See* White, *supra* note 146, at 690 ("[Some] believe that the contracting party with discretion is obliged to exercise it according to the golden rule—do unto others as you would have them do unto you."). For a discussion of the origins and content of the golden rule, see Ronen Perry, *Re-torts*, 59 ALA. L. REV. 987, 1024–25 (2008).