This Article does not appear to differ substantially from Lord Hoffmann's re-statement. Article 5.101(1) is likely to generate a degree of unease among English lawyers but no more than that aroused by Lord Hoffmann's fourth and fifth principles. Article 5.102 is slightly more contentious. It states:

> In interpreting a contract, regard shall be had, in particular, to:
> (a) the circumstances in which it was concluded, including the preliminary negotiations;
> (b) the conduct of the parties, even subsequent to the conclusion of the contract;
> (c) the nature and purpose of the contract;
> (d) the interpretation which has already been given to similar clauses by the parties and the practices they have established between themselves;
> (e) the meaning commonly given to terms and expressions in the branch of activity concerned and the interpretation similar clauses may already have received;
> (f) usages; and
> (g) good faith and fair dealing.

Paragraphs (a), (b) and (g) seem clearly to go beyond the current limits of English law. Those who maintain that Lord Hoffmann has not gone far enough argue that English law should embrace propositions (a) and (b) so that courts will in future be free to assess for themselves the probative value of such evidence (which may not be great). On the other hand, care must be taken not to lengthen trials by enabling the parties to swamp the court with evidence of dubious value. Paragraph (g) is also of interest. English contract law currently does not impose on contracting parties a duty of good faith and fair dealing. However good faith and fair dealing play a vital role in civilian systems. A huge gulf thus appears to exist between English law and Continental systems. But the difference may be more one of technique than outcome. As Lord Hoffmann observed in *O'Neill v Phillips*,[102] the result which an English court might achieve by adopting a less literal approach to interpretation might well by reached in a Continental court by the use of a general requirement of good faith. So, at the end of the day, the matter may turn out to be no more than 'different ways of doing the same thing.' We may yet move in the direction pointed by Article 5–102 of the Principles.

[102] [1999] 1 WLR 1092, 1101.

7

The Uses of Ambiguity in Commercial Contracts: On Facilitating Re-Bargaining

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I. INTRODUCTION

THIS CHAPTER ASKS why we observe in various common law jurisdictions the judicial invocation of an evolutionary concept: the implied duty of good faith in contracts between parties who under traditional principles would not be considered fiduciaries for each other. This is puzzling if, with some American commentators, we tend to think (1) that an efficient contract law is one that enforces the ascertainable intent of the contractual parties and minimises imposition through the contract of rights or duties other than those agreed upon; and (2) that the common law of contracts tends to evolve in a way that makes sense (is efficient).

We concur in the conventional view that clarity in legal rights and duties is one of the principal goals of contract law. Clear rules allow for the creation of clear obligations and permit parties to best understand and price the performances about which they contract. Accurate pricing of contract performances in turn aids the achievement of an efficient allocation of goods, services and the capital that supports the production of goods and services. Thus ambiguity in rights and duties can be costly. But we wish in this essay to note a small but we hope interesting caveat.

In this chapter we wish to argue that in some circumstances clarity in the fixing of default legal rights may not improve contract efficiency. Ambiguity has its uses. It is not always simply a flaw or a regrettable feature of a legal system, but can sometimes be a productive state. We undertake to demonstrate this through a discussion of the effects of the ambiguity that inevitably arises from the doctrine of an implied covenant of good faith and fair dealing.

or how they ought to be fashioned in order to work well, that incorporate some or all of these additional assumptions should, we imagine, be more helpful in the practical work that lawyers and judges do.

Scholars in the US at least, who seek to use economic rationality as an analytic technique in understanding legal institutions—either the neo-classical version or the more realistic version—take a stance regarding change in legal institutions that looks vaguely Darwinian. It sees the common law system with its relatively strong commitment to human liberty and decentralised (judicial) law creation as permitting great experimentation. To such observers, decentralised common law systems permit gradual system change towards a more satisfactory (efficient) set of rules. Inefficient rules may emerge of course, but the costly aspects of the rule become apparent over time and sytemtic adaptation occurs. It is thought that in time an efficient rule will be stable (while its environment is stable) and the system will move towards such rules. To a functionalist, the existence of an established legal pattern is an implicit invitation to imagine in what way it serves an economic purpose. This essay is in that spirit.

We want to offer an efficiency-based account of the evolution of the 'good faith' term implied in modern US contracts. Thus, we offer a functional account of why and in which circumstances the implication of this duty would be useful to the parties' joint interest at the time of contracting (*'ex ante'*). To produce the 'bottom line' immediately we suggest that the implied doctrine of good faith is useful in long-term contracts precisely because it is ambiguous. This ambiguity, we assert, can facilitate *ex post* re-bargaining of a contract after an unknown future state is revealed to the contracting parties and it can help to produce results on re-contracting that are distributionally more equal than otherwise would occur. We suggest that this indeed is the result that parties would tend to seek behind the veil of ignorance that exists at the time of contracting. Thus we assert that the ambiguity that arises from the implied obligation is an aid to contracting parties and is efficient in such cases. We do not claim that courts have restricted use of the doctrine to these circumstances, but this interpretation does, we think, suggest one way in which this doctrine (and ambiguity in contract law) can be functionally useful.

We begin by asking the reader to consider a hypothetical case of a complex contract.

II. A HYPOTHETICAL CASE

Bigco, Inc. is a manufacturer of filtration systems for industrial uses at a Texas plant. It uses a semi-refined material (stuff) in its manufacturing process. Stuff contributes about 15 per cent of the marginal manufacturing costs of Bigco's products. Over the last five years Bigco's Texas requirements for stuff fluctuated between 50,000 and 75,000 lbs each month (average 60,000).

It has been paying an average price of $3.40 a pound to its supplier, Ajax Corp., but Ajax has been unreliable and the relationship was terminated in 2001.

That same year Bigco negotiated with Supplier Inc. Supplier proposed a different approach. It proposed to build a small refining unit right on Bigco's property at a cost of $1.6 million which would permit it to profitably supply all of Bigco's stuff needs for average prices between $2.40 and $2.60 per pound. Supplier calculates that the plant would have at least an eight-year life. If it charges off the capital cost plus interest over the period the charge would be $650,000 per year. Supplier calculates that on the expected (average) requirement of 720,000 pounds per year, it will have a 20 per cent profit margin, net of its costs of capital. Thus it foresees expected profits per year of $360,000 (720,000 pounds × $2.50 per pound × .20 = $360,000).

A contract is signed on 2 January 2001. It provides that Supplier will be the exclusive supplier of stuff for the Bigco plant in Texas for a period of not less than eight years on terms consistent with its proposal, with a provision for price adjustments in light of any changes in a bench market indicator of stuff prices, with a guaranteed price of at least $2.00 per pound and a top price of no more than $4.40 a pound, over the term of the contract. Supplier immediately commences to construct the refining unit and shortly thereafter deliveries begin.

In May 2002, Gemax, a competitor of Supplier, introduced a new, advanced technology for refining stuff. The new technology improved the duration of the product's lifetime, while shortening the production time by eliminating two of the expensive stages that were used in the old refining process. They now sell stuff for $1.60 a pound. Understanding it is bound by a contract for 'no less than eight years', Bigco asks Supplier to reduce the price for stuff to $1.65 a pound. Supplier, who carefully calculated its expenses in accordance with the estimated requirements and prices, recognizes that it cannot afford the price reduction, and therefore refuses. Bigco is frustrated. An audit of the Texas plant operations discloses that given all of the recent changes it can expect to operate the Texas plant at no more than a $50,000 annual profit.

Bigco then announces on 1 January 2003 that it will relocate the operations of its Texas plant to a Mississippi plant which will be refitted for that purpose. Employees will be offered employment at different Bigco operations. Supplier is enraged by this decision. Its investment will have a value of $100,000 as scrap if not used for its intended purpose at the Bigco Texas site.

Has Bigco breached any obligation that it owed to Supplier? One answer, a plausible one, is no, it has not. If Supplier needed assurance that the contract would continue for eight years in order to assure recovery of all of its investment it should have negotiated for a covenant that the plant would operate at present levels for the eight year term of the contract. This answer simply leaves the parties where they are. It is almost certainly the result that would obtain if there were no implied obligation of good faith and fair dealing. And for some of us I suppose this result does not leave us feeling as if some egregious wrong has been left unrighted.