The Principle of Loyalty and Flexibility in Contracts

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Flexibility is needed especially in long-term cooperative agreements, which should work over time and adapt to changing circumstances. The aim of this article is to highlight how the Nordic principle of loyalty can facilitate the conclusion of more flexible contracts. The method used is the traditional legal method (Rechtsdogmatik).

The principle of loyalty, the Nordic equivalent to the principle of good faith in the civil law countries of Continental Europe, requires that the parties to a contract have due regard to the other party's interests during the contract negotiations and performance, but also after the contract has been executed. The principle of loyalty may, for example, oblige a party to inform the other party of issues that are relevant for his performance or require renegotiation of the contract due to changing circumstances. By clarifying for the parties the behaviour that can be expected of them, as well as what they can expect from others, the principle of loyalty facilitates trust and makes it easier for parties to dare enter into more flexible contracts. The parties can also ascertain that the principle of loyalty will be given weight in the interpretation of the contract through their drafting technique, as we show in the article.

Flexible, long-term contracts are likely to include gaps and leave room for interpretation, which increases uncertainty. In the article we argue that the principle of loyalty proves to be beneficial in these situations. As the principle of loyalty functions as a legal basis for protection of the parties' legitimate expectations, the gaps of the contract can often be filled with what is perceived as "normal" for the type of contract within the said trade. This reduces the need for highly detailed, complete contracts.

As a result, the knowledge of the existence of the principle of loyalty might support the parties' choice to conclude a flexible contract.

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1. Introduction

Good contracts are needed in commerce. By this we mean well-working contracts from the parties' perspective. Since many commercial contracts are typically long-term cooperative arrangements, they should be flexible enough to work over time and changing circumstances.

A well-working contract can also contain open questions, perhaps even conscious gaps, since the parties have decided to modify their contract to the extent needed during its term. The reason for such a decision can be strictly economic: If the parties trust one another it is easier, faster and cheaper to conclude a more rudimentary contract. Real-life contracts do not always, however, contain the flexibility needed in the form of, for example, clauses on renegotiation, hardship and alternative dispute resolution (ADR).

The main objective of this article is to highlight that the so called principle of loyalty in Nordic contract law can promote the use of flexibility in contracts. This follows from the principle's function of building trust between the parties, wherefore it can hinder opportunistic behaviour. And trusting parties dare enter into more flexible contracts. In other words, we find that the principle of loyalty is a helpful norm when it comes to flexibility in contracts.

2. The Principle of Loyalty as a Nordic Phenomenon

The principle of loyalty, the Nordic equivalent to the principle of good faith in the civil law countries of Continental Europe, refers to the set of obligations, which contracting parties have towards each other. Similarly to the good faith principle (or "*Treu und Glauben*" and "*bonne foi*" principles) the principle of loyalty requires that the parties to a contract have due regard to the other party's interests during the contract negotiations and performance, but also after the contract has been executed. The principle of loyalty promotes the realisation of an agreement by directing behaviour so that the other party's reasonable expectations will be met.[4]

[4] Taxell, L.E. (1972), *Avtal och rättsskydd*, Åbo Akademi, p. 81, Ämmälä, T. (1994), "Lojaliteettiperiaattesta eräiden sopimustyyppien yhteydessä", in Saarnilehto, A. (Ed.),

The principle of loyalty is primarily focused on behaviour and not actual contract terms.[5] Parties are, for example, obliged to contribute to the realisation of common goals and refrain from causing harm to the other party, while fairness or unfairness of the contract itself is to be resolved under the principle of conscionability found in Section 36 of the Contracts Act: "If a contract term is unfair or its application would lead to an unfair result, the term may be adjusted or set aside."

The Nordic principle of loyalty is moreover characterised by its close connection to other contract law principles, for example the aforementioned principle of conscionability. As it does not diverge clearly from other contractual principles it cannot be exhaustively defined, but its content should be determined instead *in casu*.[6]

The principle of loyalty as such cannot be found in any laws in Finland, but many sections of different laws have been linked to the said principle and it has also been recognised in certain *travaux préparatoires* (preparatory work on legislation). The principle of loyalty is recognised in decisions by courts and arbitration panels as well as in contract practices. Today most scholars consider it an existing general principle of law, that is a legal principle acceptable according to the values of society.[7] Rules and principles are both legal norms. As a legal rule can be described with the expression "either–or", which means that the rule either comes into effect in a certain situation or it does not, a legal principle is, however, more correctly described with the expression "more–or–less". This means that the principle can come into effect to a different extent in different situations.[8]

Although the principle of loyalty has been then generally accepted in Finland, its actual

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Lojaliteettiperiaatteesta – Vastapuolen edun huomioon ottamisesta eri oikeudenaloilla, Turun yliopiston oikeustieteellisen tiedekunnan julkaisuja, Turku, pp. 3–50 (pp. 4–9), Munukka, J. (2007), *Kontraktuell lojalitetsplikt*, Jure Förlag AB, Stockholm, pp. 73–101.

[5] Munukka J. (2005): "Harmonisation of Contract Law: In Search of a Solution to the Good Faith Problem", *Scandinavian Studies in Law*, pp. 229 – 250 (p. 242).

[6] Taxell (1972), pp. 75–82, Ämmälä (1994), pp. 10–11, Karhu J. (2008): "Lojaliteettiperiaate sopimusoikeudessa – oikeudellista peruskartoitusta", in *Juhlajulkaisu Leena Kartio 1938 – 30/8 – 2008*, Suomalainen lakimiesyhdistys, Helsinki, pp. 101 – 116 (p. 103).

[7] Sund-Norrgård P. (2011), *Lojalitet i licensavtal*, Publications of IPR University Center, Juridiska föreningens publikationsserie nr 56, Helsinki, p. 58 and references.

[8] Dworkin, R. (1978), *Taking Rights Seriously*, Harvard University Press, Cambridge, pp. 22–28, 71–80, Aarnio, A. (1989), *Laintulkinnan teoria, Yleisen oikeustieteen oppikirja*, WSOY, Helsinki, pp. 78–83, Peczenik, A. (1995), *Juridikens teori och metod*, Fritzes Förlag, Stockholm, p. 75, Tuori, K. (2008), *Rättens nivåer och dimensioner*, Yliopistopaino, Helsingfors, p. 55.

content, theoretical basis and applicability has been quite widely debated.[9] The situation seems to be similar in the other Nordic countries, where the principle of loyalty also lacks a clear statutory basis. For example in Sweden it has been unclear whether the principle of loyalty should be considered a general contract law principle or whether its applicability is limited only to some types of contracts.[10]

In this article we have chosen to use the term principle of loyalty instead of good faith to emphasise the Nordic point of view while approaching the discussion about flexibility. This term corresponds to the Finnish "*lojaliteettiperiaate*", Swedish "*lojalitetsprincip*", and Norwegian and Danish "*loyalitetsprincip*".

3. "Complete" contracts v. flexible contracts

3.1. The importance of legal and business knowledge in contract drafting

Contracts are often drafted by businessmen without any help from lawyers, and many times this works very well. It is, however, always a good thing to remember that even the simplest contract is in essence a legal construction.

A businessman concluding, for example, contracts on sale of real property in Finland without legal help, needs to know the content of the Finnish Code of Real Estate anyway. This follows from the simple fact that if a sale of real property is not concluded in accordance with the mandatory provisions of the said Code, the sale is considered null and void.

It is also a fact that if parties in a given situation – not requiring compliance to mandatory rules – do not use their freedom of contract, a judge will apply default rules, should the parties ever end up in a courtroom or arbitration. In other words, in order to make informed decisions on how to use their freedom of contract the parties need to know what might follow if they do not. It is therefore often a good idea to involve lawyers in the contract drafting

[9] Muukkonen, P.J. (1993) "Sopimusoikeuden yleinen lojaliteettiperiaate", *Lakimies*, pp. 1030–1048 (pp. 1033, 1039–1040), Mähönen J. (2000b): "'Good Faith and Fair Dealing' ja lojaliteettivelvollisuus", in *Juhlajulkaisu Tuula Ämmälä 2.11.2000*, Turun yliopiston oikeustieteellisen tiedekunnan julkaisuja, Turku, pp. 203 – 231 (pp. 222–223).
[10] Munukka (2005), pp. 235–238, Munukka (2007), pp. 10, 62.

process.

Before any contracts are to be concluded, the businessmen and their lawyers should "educate" one another. The businessmen should convey information on the business to the lawyers; this can be especially important for companies that lack in-house counsels and therefore need to seek outside legal help from people more unfamiliar with their business. It is likely that lawyers who do not understand the business are of less use to the businessmen than lawyers who do. Lawyers, on the other hand, should convey information on the law to the businessmen, since no contract is concluded in total detachment from the background law. This is so even though contracts have many functions, many of them certainly non-legal ones.

3.2. The contract should work for the parties

When a contract is to be concluded, the businessmen and their lawyers should think proactively. In order to end up with a well-working end product, they should avoid drafting contracts that could be described as mechanical and stereotyped in favour of more conscious and goal-oriented ones that actually work for the parties. This means that the parties' intentions, goals, and expectations must be made clear, after which the drafting technique should be chosen accordingly.[11]

If the parties feel the need to focus on risk allocation, a detailed, complete contract covering most, if not all, aspects of the transaction might be optimal. This may be the case if the parties do not know one another and therefore do not trust one another, and they are about to conclude a short-term contract in a situation where the circumstances are stable. On the other hand, if the parties are about to enter into a long-term, close cooperation based on trust, in a situation where the circumstances are unstable and alter rapidly, it is likely that a detailed, complete contract with rigid terms will lack the flexibility needed and therefore make the

[11] Pohjonen, S. (2005): "Ennakoiva oikeus – dialogista oikeutta", in Pohjonen, S. (Ed.), *Ex ante – ennakoiva oikeus*, Talentum, Helsinki, pp. 11–44 (pp. 12–13), Haapio, H. (2007), "An Ounce of Prevention… – Proactive Legal Care for Corporate Contracting Success", *Tidskrift utgiven av Juridiska Föreningen i Finland*, pp. 39–68 (pp. 40, 50–51), Pohjonen, S. (2009): "Law and Business – Successful Business Contracting, Corporate Social Responsibility and Legal Thinking", *Tidskrift utgiven av Juridiska Föreningen i Finland*, pp. 470–484 (pp. 477–478).

cooperation more difficult. As a result, the contract might work only if its wording is *not* followed, that is if the parties decide to apply the contract in a flexible manner even though the contract itself does not allow it. Surely businessmen, as well as their lawyers, must strive for better contracts than that.[12]

It also needs to be pointed out that in many situations it is not even possible to draft a complete contract without gaps. Not only will it be too expensive to try to cover every aspect of the transaction, it will be impossible, since the future cannot be foreseen. Instead the cooperating parties will benefit from a more flexible contract that can be modified to the extent needed during its term. Since the parties strive for something more than short-term profit, they cooperate and focus on the principal aims of the contract. Keeping track of possible minor details in the contract is perceived as less important.[13] Since the parties depend on one another, it is also usually in both their interests to keep the contract in force. Therefore, it is logical for them to solve problems through discussion and negotiation if, and when, they occur.[14]

Anyhow, it is essential that parties think things through before concluding a contract. If you feel that the other party really can be trusted and you see yourself as cooperating smoothly for many years towards a common goal, flexibility is probably the right way to go. On the other hand, if you have doubts and feel that profound problems are possible in the future, flexibility can indeed be risky. In such a case short-term contracts with more rigid terms are probably better; for example a well-designed liability clause can be of great help in cases like these. The true difficulty in contract drafting lies therefore in finding the right balance, for the situation at hand, between certainty/security and flexibility.

[12] Sund-Norrgård (2011), pp. 100–103.
[13] Nassar, N. (1995), *Sanctity of Contracts Revisited. A study in the Theory and Practice of Long-Term International Commercial Transactions*, M. Nijhoff, Dordrect, London (etc.), pp. 21–23, 218–219, Grönfors, K. (1995), Avtal och omförhandling, Nerenius & Santérus Förlag AB, Stockholm, pp. 22–23.
[14] Pöyhönen, J. (1988), *Sopimusoikeuden järjestelmä ja sopimusten sovittelu*, Suomalainen Lakimiesyhdistys, Helsinki, pp. 211–213, Nassar (1995), pp. 67, 71–73, 218–219, Nystén-Haarala, S. (1998), *The Long-Term Contract. Contract Law and Contracting*, Kauppakaari Oyj Finnish Lawyers' Publishing, Helsinki, pp. 8, 27, 35, Macneil, Ian R. (2001), *The Relational Theory of Contract: Selected Works of Ian Mcneil*, David Campbell (ed.), Sweet & Maxwell, London, p. 197.

4. How the principle of loyalty makes flexibility easier

Since the principle of loyalty is considered part of Nordic contract law this can in fact facilitate the conclusion of more flexible contracts. This assertion essentially follows from the notion that the principle of loyalty may help increasing trust between the parties.[15] Namely, as long as the content of the principle of loyalty is not perceived as too vague and imprecise, it may help clarifying for the parties the behaviour that can be expected of them, as well as what they can expect from others. The parties have a moral, as well as a legal, duty to act in accordance with such "business sense".

When talking about the legal duty to act in accordance with the principle of loyalty it is nonetheless a question of debate whether a breach of the said principle in fact constitutes a breach of contract followed by sanctions, or if the principle is somehow weaker than that. Support for the view that a breach of the principle of loyalty in itself may constitute a breach of contract is found in the legal doctrine,[16] as well as in decisions KKO 1993:130, KKO 2007:72 and KKO 2008:91 of the Finnish Supreme Court. There are also scholars who view breach of contract and breach of the principle of loyalty as separate issues.[17]

The content of the principle of loyalty is essentially based on so called legitimate expectations. For example an existing trade custom in the market in question can be relevant as to what can be expected based on it. This follows from the notion that a party to a contract, as a starting point, is entitled to expect the other party to act in a way perceived as "normal" for the type of contract in question within the said trade. As a result, the expectations of what follows from the application of the principle of loyalty vary.[18]

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[15] Mähönen (2000b), pp. 213–215, Sund-Norrgård (2011), p. 106.
[16] Muukkonen, P. J. (1975), "Yhteistyösopimukset ja lojaliteettivelvollisuus", in Hoppu, E. et al (Ed.), *Juhlajulkaisu Urho Kaleva Kekkonen, 1900 – 3/9 – 1975*, Suomalainen Lakimiesyhdistys, Helsinki, pp. 356–364 (p. 364), Pöyhönen (1988), p. 19, Nicander, H. (1995–96), "Lojalitetsplikt före, under och efter avtalsförhållanden", *Juridisk Tidskrift vid Stockholms universitet*, pp. 31–49 (pp. 33, 36), Sund-Norrgård (2011), pp. 280–281.
[17] Aurejärvi, E. (1993), "Virallisen vastaväittäjän professori Erkki Aurejärven Turun yliopiston oikeustieteelliselle tiedekunnalle antama 14.9.1993 päivätty lausunto Ari Huhtamäen väitöskirjasta Luotonatajavastuu, Lender Liability Suomessa – velvoiteoikeudellinen tutkimus luotonantajan vastuusta luotonottajaa kohtaan erityisesti USA:n oikeuteen verrattuna", *Lakimies*, pp. 1095–1127 (p. 1102), Mononen, M. (2001), *Sopimusoikeuden materiaalisuudesta*, Helsingin yliopiston verkkojulkaisut – e-thesis, Helsinki, p. 164.
[18] Nassar (1995), pp. 190, 237, Nazarian, H. (2007), *Lojalitetsplikt i kontraktsforhold*, Cappelen Akademisk Forlag, Oslo, pp. 316–317.

The notion that one should not deviate from what is considered normal behaviour may very well be helpful in the building of trust between the parties, which in itself might suppress a possible temptation to behave in a short-term opportunistic way. Since cooperation within long-term contracts normally cannot work without trust, trust is rational.[19] And it is certainly easier to trust someone if the risk of being let down is considered small.[20] The assessment is then essentially based on the interests of the party one intends to trust: the likelihood of him acting in a favourable manner – or at least not in a harmful manner – is considered high enough for you to contemplate cooperation with him.[21] A party that needs the other party in order to reach a certain goal will be less tempted to act in a short-term opportunistic way, and will therefore also be more trustworthy.

In a situation where contract parties trust one another they lack the need to safeguard against opportunistic behaviour. This means that they also lack the need to strive for contracts covering every possible aspect of their transaction, and can settle for more flexible, and probably cheaper, contracts instead.

In sum, even though the content of the principle of loyalty may seem somewhat vague, it really does exist. It is a "real" norm that can be helpful, for example, in the contract drafting.

5. How to use the principle of loyalty to make contracts flexible

Since the purpose of the judicial system cannot be to protect disloyal behaviour, the principle of loyalty is considered a prescriptive norm that always applies.[22] This means that freedom of contract is limited by the principle of loyalty, and not the other way around. Such a conclusion can be drawn also from Article 1:201 in PECL, Article 1.7 in Unidroit Principles and DCFR III. – 1:103, according to which the principle of *good faith and fair dealing* is

[19] Nystén-Haarala (1998), p. 33.
[20] Nooteboom B. (2002), *Trust. Forms, Foundations, Functions, Failures, and Figures*, Edward Elgar Publishing, Great Britain, p. 37.
[21] Gambetta, D. (1988), "Can We Trust Trust?", in Gambetta, D. (Ed.), *Trust. Making and Breaking Cooperative Relations*, Basil Blackwell, Oxford, pp. 213–237 (pp. 217–218), Dasgupta, P. (1988), "Trust as a Commodity", in Gambetta, D. (Ed.), *Trust. Making and Breaking Cooperative Relations*, Basil Blackwell, Oxford, pp. 49–72 (pp. 50–51), Hardin, R. (1992), "The Street-Level Epistemology of Trust", *Analyse & Kritik*, pp. 152–176 (pp. 152–153).
[22] Holm, A. (2004), *Den avtalsgrundade lojalitetsplikten – en allmän rättsprincip*, Linköpings universitet, Linköping, p. 18.

mandatory and may not be excluded or limited by contract. This is, however, mainly true for the moral foundations of the principle of loyalty,[23] since the contract itself also has an impact on the content of the principle of loyalty; this is true for PECL and DCFR as well.[24] So, although the principle of loyalty cannot – and should not – be avoided, the content of a contract concluded between parties of equal bargaining power can have an impact on what, in their case, is to be considered loyal behaviour.[25]

From this notion one can draw the conclusion that if the parties' contract can be understood rather as a framework for a flexible process of on-going cooperation than as a device for precise risk allocation, the principle of loyalty will have a greater significance in the interpretation of the contract. A contract of this kind shows that the parties have a need for loyal behaviour and trust, since they depend upon each other and therefore are more vulnerable. Through the drafting technique it is then possible (within certain limits) to effect the functions of the contract. The parties can, for example, ascertain that the principle of loyalty will be given weight when there are gaps in the contract that have to be filled, or when the contract has to be interpreted by a third party.

Occasionally also parties engaged in long-term cooperative arrangements cannot solve their problems through negotiations. Even though it is usually not recommendable to take a dispute all the way to court proceedings or arbitration, this certainly happens sometimes. We need therefore to address the question of what happens when a more rudimentary, flexible contract is to be interpreted for example in court. That is, when the purpose of the contract/the common goal of the parties is to be identified.

When a contract is interpreted, the purpose of the contract prevails. This is true also for a situation where the purpose contradicts a contract's wording (if the purpose can be identified). This notion does not, however, change the fact that the wording of the contract

[23] Nazarian (2007), p. 136.
[24] *Principles of European Contract Law, Parts I and II* (2000), Prepared by The Commission on European Contract Law, Lando, O. and Beale, H. (Ed.), Kluwer Law International, The Hague, London, Boston, p. 116, *Draft Common Frame of Reference (DCFR)*, Full Edition Volume 1 Book III (2009), Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), Based in part on a revised version of the Principles of European Contract Law, von Bar C. and Clive, E. (Ed.), sellier. european law publishers GmbH, Munich, p. 677.
[25] Nazarian (2007), pp. 137–138.

will remain the starting point, as well as the primary source, for interpretation. Since parties usually write down their common aim in a contract, this convention is natural. A clear outcome based on the interpretation of a contract's wording is, therefore, not easily dismissed.[26]

Having said this it is nonetheless clear that contracts today should be interpreted as a whole. This follows from, for example, decision KKO 2001:34 of the Finnish Supreme Court. In the interpretation the focus should be on all of the relevant circumstances of the case at hand and not solely on the written contract document. This convention that the law allows for the consideration of more extensive material in contract interpretation sounds perfect in theory. In practice, it is not always done. Instead many courts only consider the contract document in the interpretation.[27] From this point of view it may, therefore, be perceived as risky to conclude a very flexible contract. It may hand over too much power to the judge should the parties ever find themselves in a courtroom.

The parties can ensure that the principle of loyalty will be given weight in the interpretation of the contract by clearly explaining in the preamble their intention to strive for a mutual goal through loyal and close cooperation on terms that are favourable for both of them. An explicit loyalty clause can also be included in the contract stipulating that the parties will act in good faith towards each other in every respect during the term of the contract. The parties can moreover include renegotiation and/or hardship clauses in their contract in order to ensure that the agreed upon terms and the risk division in the contract can be altered through negotiations in good faith when needed. A logical next step, should none of the attempts to renegotiate lead to an acceptable solution of the problem, would be ADR in the form of mediation.[28] Also in mediation the goal is to find a business solution to the problem instead of focusing on who "wins" and who "looses".[29] In situations where parties do not trust one

[26] Hemmo, M. (2008), *Sopimusoikeuden oppikirja*, Talentum, Helsinki, pp. 305–306, Saarnilehto, A. (2009), *Sopimusoikeuden perusteet*, Talentum Lakimiesliiton kustannus, Helsinki, pp. 149, 153, Ramberg, J. and Ramberg C. (2014) *Allmän avtalsrätt*, nionde upplagan, Norstedts Juridik AB, Stockholm, p. 144.
[27] Hemmo (2008), p. 305, Ramberg and Ramberg (2014), p. 145.
[28] Sund-Norrgård, P. (2013), "Omförhandling och medling – Att lösa konflikter och fortsätta samarbeta", *Tidsskrift for Rettsvitenskap*, pp. 315–342 (p. 331).
[29] Ervasti, K. (2000), "Tuomioistuinten ulkopuolinen riitojen ratkaisu – Näkökulmia vaihtoehtoisiin konfliktinratkaisumenetelmiin", *Lakimies*, pp. 1237–1263 (pp. 1250–1251), Knuts, G. (2006), *Förfarandegarantier vid domstolsanknuten medling*, Suomalainen Lakimiesyhdistys, Helsingfors, pp. 47–51.

another they will probably not include loyalty clauses or terms involving problem solving *inter partes* or through ADR in the contract.[30]

On the other hand, a very precise and rigid contract document that focuses on risk division gives little room for other circumstances than the wording of the contract to be considered in the interpretation. The parties can, for example, through including a *merger clause* in the contract stipulating that the written contract contains the entire agreement on the issue at hand, avoid that pre-contractual behaviours and negotiations are given weight in the interpretation. If also a *written modification clause* is included stipulating that amendments to the contract have to be in writing in order to be valid, the parties can avoid that events occurring after the conclusion of the contract is given weight in the interpretation. Such a clause greatly influences the interpretation of the contract, even though its validity is not absolute in all circumstances.[31] In other words the parties can, in their use of such a "classical" contracting technique, significantly hinder the impact of the principle of loyalty in the interpretation of their contract.[32]

In a perfect world the parties and their lawyers will cooperate in order to ascertain that the "optimal" contract – that is a well-working contract – can be concluded for every situation.

6. The functions and the content of the principle of loyalty

6.1. The duty to inform and other duties

The significance of the principle of loyalty varies, not only depending on the type of contract, but also depending on the phase of the contractual relationship. Loyalty and mutual trust have more prominent roles during the performance of a contract than in contract negotiations. Nevertheless, the principle of loyalty applies also in the pre-contractual phase,[33] and harm

[30] Sund-Norrgård (2011), pp. 147–151.
[31] Norros, O. (2008), "Sopimusperusteiset muotovaatimukset", *Lakimies*, pp. 183–211 (pp. 196–199).
[32] Sund-Norrgård (2011), pp. 141–144, 271–279, Sund-Norrgård P. (2012), "Lisenssisopimusten tulkinta – uudelleenarvioinnin aika?", *Oikeustiede – Jurisprudentia XLV 2012*, Suomalaisen Lakimiesyhdistyksen Julkaisuja, Helsinki, pp. 285–333 (pp. 304–315).
[33] Mähönen, J. (2000a), "Lojaliteettivelvollisuus ja tiedonantovelvollisuus", in Ari Saarnilehto (Ed.), *Varallisuusoikeuden kantavat periaatteet*, WSOY, Helsinki, pp. 129–143 (pp. 132, 135–136),

caused by disloyal behaviour during contract negotiations can lead to liability for damages to the other party.[34] The principle of loyalty may direct the parties' behaviour also after the contract has been terminated.[35]

Based on an analysis of contract law doctrine one may conclude that the principle demands, in short, that parties to a contract also consider the interests of the other party and not just act in an egoistic and opportunistic manner. Even though it is somewhat unclear what actually follows from this requirement, it is clear that the principle's significance increases in long-term contracts between parties that are financially dependent on one another. Such contracts require mutual trust and close cooperation between the contracting parties. Good examples are franchising, agency and licensing agreements, which often also include specific contract clauses on loyalty and cooperation.[36]

The principle of loyalty may, for example, oblige a party to inform the other party of issues that are relevant for his performance under the contract. This obligation to inform the other party is present, not only during the on-going contractual relationship, but already in the negotiation phase before the contract is concluded.[37] Often a party's obligation to voluntarily inform the other party of the content of the contract is also directly based on legal rules.[38] One may say, that these decisions and rules express the principle of loyalty.

The principle of loyalty can moreover induce an obligation to renegotiate an existing

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Munukka (2007), p. 154.

[34] Nystén-Haarala (1998), pp. 121–129.

[35] Taxell, L. E. (1977), "Om lojalitet i avtalsförhållanden", *Defensor Legis*, pp. 148–155 (pp.151–152), Nicander (1995–96), p. 36.

[36] Muukkonen (1975), p. 358, Taxell (1977), p. 149, Bygglin, G. (1978), "Om franchiseavtal och upplösningsfrihet", *Oikeustiede – Jurisprudentia XI 1978*, Suomalaisen Lakimiesyhdistyksen vuosikirja, Helsinki, pp. 89–157 (pp. 137–139), Taxell, L. E. (1979), "Om avtalsetik", *Tidskrift utgiven av Juridiska Föreningen i Finland*, pp. 487–498 (p. 493), Muukkonen (1993), p. 1039, Nicander (1995–96), p. 33 Häyhä J. (1996b), "Lojaliteettiperiaate ja sopimusoppi", *Defensor Legis*, pp. 313–327 (pp. 314–315), Wilhelmsson T. (2008), *Standardavtal och oskäliga avtalsvillkor*, Talentum, Helsingfors, pp. 25–26, Sund-Norrgård (2011), pp. 55–60, Ramberg and Ramberg (2014), pp. 32–34.

[37] Decisions KKO 1993:130, KKO 2007:72 and KKO 2008:91 of the Finnish Supreme Court, NJA 1978 p. 147 and NJA 1990 p. 745 of the Swedish Supreme Court, Hultmark, C. (1993), *Upplysningsplikt vid ingående av avtal*, Juristförlaget Stockholm, p. 10, Runesson, E. (1996), *Rekonstruktion av ofullständiga avtal. Särskilt om köplagens reglering av risken för ökade prestationskostnader*, Juristförlaget Stockholm, pp. 129–130, Munukka (2007), p. 154.

[38] For example Chapter 5, Section 13 of the Consumer Protection Act and Chapter 2, Section 17 of the Code of Real Estate.

contract,[39] and it may require a prohibition of competition,[40] or a secrecy obligation.[41] As the principle of loyalty applies as a general contract law principle, the parties can have obligations towards each other based on the said principle that exceed the terms of the contract.[42] This means that, for example, the duty to renegotiate a contract can be demanded of a party also where the contract itself does *not* include a clause of this kind. In spite of this, the easiest way to ensure such an obligation is, of course, to include a well-working renegotiation clause in the contract.[43]

In a situation where the contract is about to be terminated one cannot, for example, assume that a secrecy obligation for trade secrets is perceived as any less important than it was during the on-going contractual phase. On the other hand some information duties may be significantly less important at this stage.[44] When the contract is about to end the principle of loyalty may also lead to the conclusion that a contract cannot be terminated without a termination period of a certain length in order to make it possible for the other party to "recoup" and cut his losses. Or it might lead to the conclusion that a valid reason is needed for termination – especially if the termination period in the contract is very short – even though freedom to terminate a contract is the starting point in Nordic contract law.[45]

6.2. Filling gaps and modifying terms in the contract

The principle of loyalty can fill gaps in the contract, and its application may even lead to a modification of express terms in a contract.[46]

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[39] Grönfors (1995), p. 39, Nystén-Haarala (1998), p. 35.
[40] Nicander (1995–96), p. 32, Holm (2004), pp. 1–3.
[41] Ramberg and Ramberg (2014), p. 34.
[42] Häyhä (1996b), p. 314.
[43] Pöyhönen (1988), p. 374, Grönfors (1995), pp. 39, 61–67, Taxell, L. E. (1997), *Avtalsrätt. Bakgrund, Sammanfattning, Utblick*, Juristförlaget Stockholm, p. 52, Sund-Norrgård (2013), pp. 328–329.
[44] Nicander (1995–96), p. 36.
[45] Bygglin (1978), pp. 137–140, Hemmo, M. (1996), "Irtisanomisvapaus ja pitkäkestoiset liikesopimukset", *Defensor Legis*, pp. 328–346 (pp. 330–333), Runesson 1996, p. 360, Hemmo, M. (2003), *Sopimusoikeus II*, Talentum, Helsinki, pp. 385–390, Halila, H. and Hemmo, M. (2008), *Sopimustyypit*, 2. uudistettu painos, Talentum Media Oy, Helsinki, pp. 276–277, Sund-Norrgård (2011) pp. 193–205.
[46] Taxell (1972), pp. 74–75, Pöyhönen (1988), pp. 64–66, Nicander (1995–96), p. 37, Häyhä, J. (1996a), *Sopimus, laki ja vakuutustoiminta*, Suomalainen Lakimiesyhdistys, Helsinki, pp. 21–22, 221,

When one has to decide what is to be considered loyal the idea, according to the Finnish scholar Juha Häyhä, is to start from what in a similar situation is perceived as customary, and therefore predictable.[47] Häyhä speaks about the mechanism of tradition. The mechanism of tradition looks backwards. The interaction creates expectations to civil law actors, and for example recurrence can substitute a norm.[48]

As a starting point the contract is not born in an "empty space". On the contrary, there are circumstances and events around the contract, which are relevant from the legal point of view. This means that the foundation of legitimate expectations is not based only on the contract, but the contract is based on legitimate expectations too. In other words, the principle of loyalty can fill the space around the (written) contract when the parties' rights and obligations are to be determined. It also means that there are legitimate expectations already *before* the contract is concluded.[49] Examples of this can be found in the practice of the Finnish Supreme Court,[50] and also in Finnish law. For example according to Section 9.1 of the Insurance Contracts Act an insurance contract is considered to be in force to the effect understood by the policyholder on the basis of the information received, in a situation where the insurer or his represantative has failed to provide the necessary information or has given incorrect information to the policyholder, when marketing the insurance.

In a situation where the parties expect that everything will "go as usual", they might not conclude a written contract at all.[51] This can be so in a situation when there has been plenty of previous interaction between the parties, which lead them to believe that things will go on in the same way also in the future. When certain events are repeated often enough, they create expectations. Commercial and other customs have the same effect.

Häyhä (1996b), p. 319, Annola, V. (2003), *Sopimuksen dynaamisuus: Talousoikeudellinen rakennetutkimus sopimuksen täydentymisestä ja täydentymisen ohjaamisesta*, Turun yliopiston oikeustieteellisen tiedekunnan julkaisuja, Turku, pp. 31, 85–89, 199, Ramberg and Ramberg (2014), pp. 32–33.

[47] Häyhä (1996a), pp. 220–225.

[48] Häyhä, J. (2000), *Jälleenvakuutus sopimuksena*, Helsingin yliopiston oikeustieteellinen tiedekunta Helsinki, pp. 19, 122–124, 269–273.

[49] Häyhä (1996b), pp. 319, 322–323, Häyhä, J. (1998), "Oikeusperiaatteet ja sopimuksen purkaminen", in *Juhlajulkaisu Kaarlo Tuori*, Helsingin yliopiston julkisoikeuden laitoksen julkaisuja, Helsinki, pp. 115–142.

[50] KKO 1984 II 181.

[51] Macaulay, S. (1963), "Non-contractual Relations in Business: A Preliminary Study", *American Sociological Review*, pp. 1–19 (pp. 12–14).

If a party's trust is based on expectations that follow from interaction between contractual parties or from business customs, the principle of loyalty offers a method for creating flexibility in contract drafting. Since the content of a contract can often be established by these expectations, the principle of loyalty means that it is not always necessary to conclude an accurate contract without gaps. In fact, if one can trust how things will go on, there might be no need to conclude a contract at all.

The principle of loyalty can be seen as the legal basis for legal protection based on legitimate expectations that arise from outside the contract. The principle of loyalty thereby fulfils the "empty space" around the contract and makes contracting more flexible. And also in the interpretation of a contract, relevance can be given to such expectations, which are based on the reality surrounding the contract.[52] Through such an interpretation, which is connected to the principle of loyalty, it is possible to achieve more flexibility.

7. Concluding remarks

A flexible contract, which is less focused on predictability and risk allocation, can be perceived by the parties as riskier than a more rigid one. Therefore, flexible contracts should be concluded in situations where they actually work for the parties; that is when the parties, for example, are about to conclude a contract involving long-term close cooperation towards a common goal. In such a situation the parties will probably find a flexible contract more useful than a very rigid one. This follows from the fact that circumstances – as well as the parties' needs – are likely to change during the term of the agreement, wherefore also their contract must be designed to change along with such changes. Otherwise the contract will not be perceived as a well-working one.

We also believe that norms can be helpful in the contract drafting process. For example in a situation, where the parties are about to enter into a long-term cooperation, the knowledge of the existence of the principle of loyalty might support their choice to conclude a flexible contract. This follows from the fact that the principle of loyalty can help clarifying for the parties the behaviour that can be expected of them, as well as what they can expect from

[52] Decision KKO 1992:50 of the Finnish Supreme Court, Häyhä (1998), p. 137.

others. This is essentially a form of "business sense" consisting of the right to expect that the other party will act in a way perceived as "normal" for the type of contract in question within the said trade. Such legitimate expectations facilitates trust, and trust makes rigid contracts covering "everything" less important, since it is not necessary to safeguard against the other party's opportunistic behaviour. In a sense the existence of the principle of loyalty therefore makes flexibility in contracts easier.

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