Good Faith and Fair Dealing in the Context of Contract Formation by Electronic Agents

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Abstract

The principle of good faith is an important guideline for contractual behaviour that permeates civil law systems. This paper examines how this principle is applied during the negotiation stage of a contract. Select examples from civil law literature of precontractual duties of good faith, and of precontractual behaviour that is deemed to be contrary to good faith, are discussed. This is followed by a discussion of the extent to which such duties are recognised, or such behaviour proscribed, in common law jurisdictions. Some common standards for precontractual behaviour in civil and common law systems are identified. These standards, in the situation where contracts are being negotiated by or through electronic agents, would need to be reflected in the way such agents behave.

1 Introduction

Electronic agents are gradually developing from mediators in the electronic marketplace into more active players that may initiate, negotiate and conclude contracts and implement the contractual obligations undertaken. Some of the issues being discussed in disciplines such as Computer Science, Cognitive Science and Logic are how such agents should behave in order to fulfil their contractual obligations. Central notions of trust, risk and reliability are vital for there to be confidence in such technology. Contractual behaviour is regulated, to a greater or lesser extent, by existing legal norms which impose duties, conditions or requirements on a contracting party. One important guideline for contractual behaviour (Lando, 2000) that permeates civil law systems, particularly in contract law, is the requirement that parties negotiate, conclude and carry out contracts in good faith.

1.1 Good Faith as a behavioural criterion

Broadly speaking, in continental civil law systems based traditionally on the Roman legal tradition, the juridical notion of good faith (‘bona fides’) is an important behavioural criterion to assess and regulate the conduct of the contracting parties. In common law literature, the term “fair dealing” is often used, rather than the term good faith. Together with the norms which regulate the formation and execution of contracts, one finds the good faith norms which lay down a general criterion of behaviour for the contracting parties, that is, that parties are expected to act in good faith towards each other in the negotiation, formation and execution of contracts. However, the extent and scope of application of the good faith principle varies from one civil law jurisdiction to another, and this may give rise to confusion as to what its essence is and what duties stem from it.

Moreover, in other legal systems such as English law, there is no general rule requiring the parties to conform to good faith. However, many of the results which in civil law systems are achieved by requiring good faith, have been reached in English law through a different, piecemeal approach.

1.2 Research Approach

The aim of this paper is to examine the principle of good faith and fair dealing as a guideline for contractual behaviour. It will try to map the constitutive elements of good faith and fair dealing by focusing on the stage of contract negotiation and formation, in order to determine what standards and norms of behaviour are expected from parties entering into a contract. It is presumed that where contracts are negotiated by or through electronic agents, the agents would have to conform to such standards of behaviour. Select civil law jurisdictions (Germany, France and Italy) and parties, as well as the requirement that a contract should have a definite object (iii) and a lawful (iv) “causa”. See for example, article 1108 of the French Civil Code, and articles 1325 and 1425 of the Italian Civil Code of 1942.
common law jurisdictions (England and the United States) will be examined. Future work will focus on good faith in the execution of contracts.

2 Generally on good faith and fair dealing

The good faith that is the focus of this paper is that which is referred to as objective good faith which constitutes a standard of conduct to which the behaviour of a party has to conform and by which it may be judged. It should be distinguished from subjective good faith which has to do with knowledge, for example as used in the field of possession.

2.1 Civil law notion of good faith

The principle of good faith finds its origin in Roman law where good faith added an element to ‘jidicia stricta’ (‘strict law’) which enabled a court to take into account circumstances, defences and considerations of fairness which might otherwise have been excluded.

In Germany, good faith is linked with the notion of ‘Treu und Glauben’ (literally, fidelity and faith), and is enshrined in §242 of the German Bürgerliches Gesetzbuch (BGB) which provides that “the debtor is bound to perform according to the requirements of good faith, ordinary usage being taken into consideration.”

As Whittaker et al (2000b) explain, “‘Treu’ … signifies faithfulness, loyalty, fidelity, reliability; ‘Glaube’ means belief in the sense of faith or reliance. The combination of ‘Treu und Glauben’ is sometimes seen to transcend the sum of its components and is widely understood as a conceptual entity. It suggests a standard of honest, loyal and considerate behaviour, of acting with due regard for the interests of the other party, and it implies and comprises the protection of reasonable reliance. Thus it is not a legal rule with specific requirements that have to be checked but may be called an ‘open’ norm. Its content cannot be established in an abstract manner but takes shape only by the way in which it is applied.”

Though the wording of §242 is rather narrow, it had a profound effect in the area of German contract law, through the way it was developed by the courts and legal writers. It operates ‘supplendi causa’ and gives rise to a host of supplementary duties that may arise under a contract such as duties of information, disclosure, etc.

According to Galgano (1985) writing on Italian contract law, the requirement of good faith in contracting implies a duty on the contracting parties to behave correctly and loyally (‘con correttezza e lealtà’). According to Article 1337 of the Italian Civil Code, “[t]he parties, in the conduct of negotiations and the formation of the contract, shall conduct themselves according to good faith.”

French contract law was initially dominated by the idea of the ‘autonomie de la volonté’ rather than good faith. Heavy emphasis was placed on examining whether, in the circumstances leading up to the making of an agreement, there was a defect in consent of one of the parties, with the notion of ‘erreur’ being widely interpreted. The French Civil Code provides that contracts must be performed in good faith (Article 1134, para. 3) but this principle has been also extended to the negotiation and formation of contracts. However, the French courts have not given the principle of good faith the same importance as have the German courts, but similar results were obtained in France by application of a general theory of abuse of rights, developed at the end of the 19th century and based on good faith. This basically provides that a party’s right may be limited or lost if enforcing it would amount to an abuse of right. Though there appears to be no juristic agreement on its proper limits, two variants became particularly prominent (Whittaker et al, 2000b): a person being said to abuse a right if its purported exercise (i) was effected with an intention to harm another person or (ii) was contrary to its economic or social purpose.

As regards the precontractual, negotiation stage, in France, by virtue of tort law, the parties are subject to a duty to negotiate in good faith, but once the negotiations have attained a mature stage, the parties are subject to a “contractual obligation … to continue to negotiate in good faith. This obligation is sometimes expressed, but most often implicit in the structure of the preliminary dealings. A sort of ‘affectio contrahendi’ grows between the parties … this obligation strengthens as negotiation proceeds. Its extent grows: it makes one party furnish information to the other, it prevents him from putting unacceptable proposals with the aim of … causing a break-off of negotiations, or of merely pretending to negotiate seriously, while in fact he has decided to deal with a competitor, it compels him to work towards the reaching of a definite decision within a reasonable period.”

The recognition of “obligations d’information” (obligations to inform or disclose) is another development.

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3 See Whittaker et al., 2000b. Thus, in the field of possession, a person to whom a non-owner has transferred property can still acquire ownership if he is in good faith, and he is not in good faith if he knows or as a result of gross negligence does not know, that the piece of property does not belong to the transferor – see Galgano, 1985.

related to good faith in French law. Similar duties to provide information also emanate in Italian contract law.

2.2 Is there a duty of good faith in common law countries?

An important principle that permeates both civil and common law contract law is the freedom of the parties to enter into contractual relations or to choose not to enter into contractual relations. Cohen (1995) describes the former as “the positive freedom of contract” in that the parties are free to create a binding contract reflecting their will, and the latter as “the negative freedom of contract” which means that the parties are free from obligations so long as a binding contract has not been concluded. However, in civil law countries, the negative freedom of contract is subject to the principle of good faith and other doctrines based on good faith such as the doctrine of abuse of right and unjustified enrichment.5

In English law, according to many writers, there is no general rule requiring the parties to negotiate in good faith (O’Connor, 1990; Whittaker, 2000b). This does not mean that there is a free-for-all, with no controls on contracting parties. The traditional rules proscribing duress, undue influence and fraud, still apply. Other than that, in English law, either party is entitled to break off negotiations at any stage before the final conclusion of the contract. Liability for pre-contractual behaviour is only imposed under limited circumstances such as fraudulent representation or negligent misstatement, as discussed more fully below.6

Although English common law recognised a principle of good faith in contractual dealings in the mid-eighteenth century,7 the modern view is that in English law, good faith is, in principle, irrelevant. Bingham L.J. stated in Interfoto Picture Library Ltd v. Stilletto Visual Programmes Ltd (1989) that, “[i]n many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as ‘play-

1 See further on this, O’Connor, 1990.
2 See section 3.1.2 infra.
3 Several legal writers make reference to the famous dictum of Lord Mansfield C.J. in 1766, that “[t]he governing principle is applicable to all contracts and dealings. Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary. But either party may be innocently silent, as to grounds open to both, to exercise their judgment upon.” See, for example, Beale, 1999.

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Many English writers often use the term “fair dealing” rather than “good faith” on the basis that the latter term “nowadays has a fuzzy sound to the ears of English lawyers” (Harrison, 1997) and may appear as a vague literary concept. The term “fair dealing” connotes observance of fairness which appears as a more objective test to common law lawyers. However, it should be emphasised that this objective connotation is also included in the civil law notion of “good faith”.

As regards the United States, the Uniform Commercial Code (UCC)8 provides in section 1-203 that “[e]very contract … imposes an obligation of good faith in its performance or enforcement.” This is mirrored in §205 of the Restatement of Contracts Second9 which states that “[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”

Good faith is defined in the UCC as “honesty in fact in the conduct or transaction concerned”.10 In the case of a merchant, the UCC provides that good faith means “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.”11

According to American jurists, similar to English law, the requirement of good faith in American law does not apply to contract negotiations.

3 Precontractual behaviour

The focus of this paper is the behaviour of the parties at the pre-contractual stage, that is, just before the parties conclude a contract or else decide not to enter into a contract.

As abovementioned, both civil and common law systems regard the freedom of the contracting parties as sacrosanct. Parties should be free to decide whether to enter into contractual relations or not. However, the question that arises is what happens where, because of certain blameworthy conduct of a contracting party at the pre-contractual stage, the contract is invalid or not perfected.

8 In 1960, the UCC was being introduced in, and adopted by the American state legislatures.
9 The Restatement Second was introduced in 1979 with official promulgation in 1981.
10 See §1-201(19) of the UCC.
11 See §2-103(1)(b) of the UCC.
The doctrine of "culpa in contrahendo", stemming from an article by the German jurist Jhering in 1861, is based on the notion that damages should be recoverable against the party whose blameworthy conduct during negotiations for a contract brought about its invalidity or prevented its perfection. Jhering's thesis has strongly influenced the development of many, though not all, civil law systems, not least of which the German and Italian legal systems. "Culpa in contrahendo" has become an important doctrine in German law, developed by case law with the aid of legal literature. This doctrine became anchored in the principle of good faith and fair dealing. According to case law, once parties enter into negotiations for a contract, a special relationship is created between the parties, giving rise to rights and duties. Thus, protection is accorded against blameworthy conduct which prevents the consummation of the contract. (Kessler et al, 1964).

From the above discussion on the meaning of the principle of good faith in civil law countries, where terms such as "honesty", "faithfulness", "loyalty", "fidelity" and "reliability" are used, it appears difficult to envisage how such characteristics could be portrayed by electronic agents. Therefore, some select examples from civil law literature of precontractual duties of good faith, and of precontractual behaviour that is deemed to be contrary to good faith, will be discussed. An attempt will be made to determine whether, and to what extent, such duties are recognised, or such behaviour proscribed, in common law jurisdictions. The aim is to identify common standards for precontractual behaviour in civil and common law systems. Any such standards, in the situation where contracts are being negotiated by or through electronic agents, would have to be reflected in the way such agents behave.

It is therefore proposed to examine, in the following sections:

- the applicability the obligation of information or the duty to disclose and the extent to which, if at all, it applies in the negotiating stage (section 3.1);

- the situation where there is a rupture of negotiations, with particular reference to sudden and unjustified rupture of negotiations (section 3.2);

- the situation where one of the parties has no real intention to contract (section 3.3).

### 3.1 Obligation to provide information

#### 3.1.1 Obligation to provide information in civil law systems

In civil law systems, as a consequence of good faith, one finds duties of information or disclosure imposed on the negotiating parties in the interest of fair dealing and the security of transactions. According to Kessler (1964) referring to civil law, each party is bound to disclose such matters as are clearly of importance for the other party's decision, provided the latter is unable to procure the information himself and the nondisclosing party is aware of the fact. Galgano (1985) explains further that the disclosure should be of circumstances of which the other party is ignorant when these can be determining factors to such party's consent, in the sense that had such party known of the existence of these factors, he/she would have offered different conditions or opted not to contract at all. Galgano gives the example of the seller being in bad faith if he fails to inform a prospective purchaser of a piece of commercial land that there exist plans at the local council office to modify the destination of the area in question. In this case, one would not be able to annul the contract on the basis of there being an error in the object of the contract, since at the moment of transfer of the land, such land is still considered to be commercial land.

In Italy, a specific example of this duty of information is given in Article 1338 which provides that a party who knows or should know of the existence of a reason for invalidity of the contract and does not give notice to the other party is bound to compensate for the damage suffered by the latter by relying, without fault, on the validity of the contract.

However, even in countries like Germany which impose a duty to disclose material matters inaccessible to the other party, this duty is not imposed indiscriminately. The courts have been aware and taken account of the natural antagonism of interest between the seller and the buyer. Therefore, the scope of the duty of disclosure varies with the type of transaction involved and with the circumstances of the individual case. Stricter demands of disclosure are made in transactions of a fiduciary nature such as insurance, partnership or mandate, than in sale or lease.

France has a highly developed notion of duties of disclosure which has evolved both through direct legisla-
tion\textsuperscript{13} and through case law. A party should disclose only such information as is relevant, having regard to the subject matter of the contract and to the obligations undertaken by the parties. For instance, in a contact of sale of a machine, the seller should inform the buyer of the conditions of use of the machine; however, the same obligation does not arise for the person who repairs it. Duties of disclosure arise due to the parties’ unequal information. However, a party’s lack of knowledge should be legitimate. The Cour de cassation states that the contracting party who made a mistake by being too gullible or careless in checking some information has only himself to blame (Fabre-Magnan, 1995). A party is allowed to be unaware of information if it was impossible for him to know it or if he could legitimately rely on the information given by the other party.

Since in most cases where the duty to disclose was violated the other party, if correctly informed, would have abstained from entering into the contract, such party will not be able to recover the value of the promised performance (the expectation interest, i.e. the benefit anticipated) but the reliance interest (for relying on the validity of the contract).

\subsection*{3.1.2 The situation in common law systems}

In common law, the situation appears to be different to that prevalent in civil law countries. As abovementioned, there is no duty to negotiate in good faith. However, Harrison (1997) explains that “the duty ‘bites’ when the contract is made. Something rather like a contractual Judgment Day occurs at this point, exposing the seller’s evasions, pregnant half-truths and the like, and penalising him for failing in his duty of good faith by deeming the contractual provisions to have included the duty of good faith.”

Although the main rule is “caveat emptor” (let the buyer beware) and thus “there is no legal obligation on the vendor to inform the purchaser that he is under a mistake, not induced by the act of the vendor” (Smith v. Hughes, 1871), certain implied warranties developed in English sale of goods law which, to a certain extent, have reduced the effect of “caveat emptor” in this area. As Whittaker et al (2000a) explain, “where English law sees the circumstances as ones in which one of the parties to the contract is in a position to know of the characteristics of the subject matter of the contract and the other is not, it may simply place the responsibility for those characteristics being present on the shoulders of the typically knowledgeable party by means of an implied term.” Examples are the implied terms about title (that the seller has a right to sell the goods), and the implied terms about quality or fitness.\textsuperscript{14}

A distinction has been made between silence as such, i.e. mere nondisclosure, and active suppression which constitutes fraud. And, as Kessler (1964) notes, it has become increasingly difficult to draw a clear line between them. Kessler quotes Turner v. Harvey (1821) where it was held that “a very little is sufficient to affect the application of [caveat emptor] … If a word, if a single word be dropped which tends to mislead the vendor, that principle will not be allowed to operate.” As the New York case of Donovan v. Aeolian Co. (1936) further explains, “it depends upon the circumstances of each case whether failure to disclose is consistent with honest dealing. Where failure to disclose a material fact is calculated to induce a false impression, the distinction between concealment and affirmative misrepresentation is tenuous. Both are fraudulent.” Moreover, facts which are true when said must be corrected if they have become untrue by the time the contract is entered into.

An action will lie in tort\textsuperscript{15} for negligent misrepresentation causing loss to the representee where the relationship of the parties is such as to give rise to a duty of care (Hedley Byrne & Co Ltd v. Heller and Partners Ltd (1964)). A negligent misrepresentation is one which is made carelessly, or without reasonable grounds for believing it to be true.

Therefore, while a party who positively misleads the other party (even if innocently) will in principle be faced with rescission of the contract, a person who says nothing will be secure.\textsuperscript{16} While parties to a contract should not mislead each other as to the subject matter of the contract, whether innocently or fraudulently, they should not in general have to act so as to protect the other’s interests, but may act in their own interest.

\textsuperscript{13} For example, to protect consumers of goods and services.

\textsuperscript{14} The common law position was enshrined in the Sales of Goods Act 1979 (amended by the Sale and Supply of Goods Act 1994) which provides in section 14(1) that, except as provided in that section, there is no implied term about the quality or fitness for any particular purpose of goods supplied under a contract of sale. However, section 14(2) then goes on to provide that “[w]here the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality.”

\textsuperscript{15} I.e. outside contract, and irrespective of whether a contract will be concluded or not.

\textsuperscript{16} See further on this discussion, Whittaker et al, 2000a, and Kessler, 1964.
However, the situation is rather different in the case of fiduciary contracts such as, for example, insurance contracts and agency. In contracts of insurance, both parties have a duty to observe “the utmost good faith” towards the other party, which imposes a duty of disclosure. A special characteristic of insurance contracts is that they are based on facts and knowledge of facts which are almost invariably under and within the exclusive control of one of the parties (usually the insured), and a proper assessment of the risk could not be made unless there were full disclosure of all material facts. The insurer, very often, does not have independent means, or has impaired means, of finding out risk-relevant information, and would have to rely on disclosures made by the person applying for an insurance policy.

Similarly, in agency, an agent is expected to act with perfect good faith, requiring full disclosure of all the material circumstances, when he deals with his principal. He is required to make full disclosure of all material circumstances, when he deals with his principal’s property to acquire benefits for himself. 18

Harrison (1997) puts forward the thesis that the duty of good faith or fair dealing as it applies in the formation of contracts of sale, is normally a twin duty of candour and accuracy. This is the duty to give proper information or none at all about what is being sold in contracts outside the area of fiduciary contracts. Harrison states that this is a presumption of law and operates both as an obligation in interpreting the contract and as an additional implied term where there are no relevant express terms to be interpreted. She holds that it does not operate as regards matters which it would be normal and possible for the buyer to investigate himself. Most importantly, Harrison states that a pre-contractual breach of this duty has no effect unless a contract is made. Thus, the effect on the parties only occurs when a contract is made, but not if negotiations break down.

As regards remedies in English law, where a contract was concluded, before the Misrepresentation Act 1967, where a party was induced to enter into a contract as a result of a misrepresentation by the other party and the misrepresentation never became incorporated as a contractual term, the representee was entitled to rescind the contract whether the misrepresentation was fraudulent, negligent or wholly innocent. Beale et al (1999) explain further that at common law, the right to rescind was confined to cases in which the misrepresentation was fraudulent or in which there was a total failure of consideration, but in equity there was a right to rescind even for innocent misrepresentation. Since the Act was passed, the right of rescission is qualified (except in cases of fraud) by the court’s power to refuse rescission and award damages in lieu, and there remain certain bars to rescission, but this falls outside the scope of this paper. 19

Where negotiations broke down and a contract was not concluded, a remedy in tort for fraudulent misrepresentation or negligent misrepresentation, may be available in the circumstances mentioned above.

3.1.3 Concluding remarks on the precontractual duty of disclosure

To sum up, in most civil law systems, there is a duty of disclosure where each party is bound to disclose such matters as are clearly of importance for the other party’s decision, provided the latter is unable to procure the information himself and the nondisclosing party is aware of the fact.

As regards English law, legal writers hold that there is no such duty of disclosure at the stage of contract negotiation, save for fiduciary contracts as abovementioned. Where there has been fraudulent representation or negligent misstatement, a remedy would be available in tort. However, when negotiations have led to the conclusion of a contract, the silence of one party could be problematic for such party (who could be liable for damages and/or find the contract rescinded) where the information suppressed relates to a fact that is deemed to be an implied term. Hence the wisdom for negotiating parties, to act with “candour and accurately” (Harrison, 1997).

One may thus note the important role played by the applicable law that is used to determine a particular dispute because the rules and remedies vary as explained above, according to whether the applicable law chosen is that of a country which has a common law system or a civil law (and even in the latter, there are some differences among civil law countries, as seen above). However, some common threads may be identified and certain behaviour should be refrained from at the stage of negotiation, irrespective of whether a contract is later on concluded or not. Thus:

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18 For a further discussion of these fiduciary duties in agency law, see O’Connor, 1990.

19 For a more detailed discussion of these bars – i.e. affirmation of the contract, lapse of time or the acquisition by a third party of the rights in the sub-matter of the contract - see Beale et al, 1999.
(1) one should refrain from fraudulent misrepresentation, that is where the party has actual knowledge of the incorrectness of a certain (material) fact or facts presented as true: This appears to be closely linked to the attribute of veracity discussed in (technical) agent literature (Wooldridge et al, 1995) which states the assumption that an agent will not knowingly communicate false information.

(2) one should refrain from negligent misstatement: each party should be careful not to make remarks on facts material to the goods which fact(s) turn out to be incorrect, where such remarks are made carelessly or without reasonable grounds for believing them to be true.

Put positively, the parties should behave, as Harrison (1997) opines, with candour and accuracy and give proper information about what is being sold in contracts outside the area of fiduciary contracts.

If a contract is concluded, then, if a certain feature of the subject matter of the contract is of paramount or fundamental importance to one of the parties, such party should make its existence an essential term or condition of the contract.

3.2 Sudden and unjustified rupture of negotiations

3.2.1 To what extent is an offer binding?

Before the conclusion of a final contract, each party is free to withdraw from the negotiations, each party bears his own expenses and acts at its own risk. However, as Cohen (1995) explains, strict adherence to freedom from contract might transform it into a freedom to manipulate the rules of the game. Freedom of action which is the underlying idea of freedom of contract, may be abused.

English law tends to enable the contracting party to act according to the rules of the game and to benefit from the freedom granted by these rules. Therefore, an offer promised to be irrevocable, is still revocable under English law because it is considered not to be supported by consideration and therefore not binding (Cohen, 1995).

Nor could one try to argue that though a contract was not concluded, there was an agreement to negotiate since a contact to negotiate is not recognised in English law. In Courtner & Fairbairn Ltd v. Tolaini Brothers (Hotels) Ltd (1975), such a contract was held to be unenforceable because “[i]f the law does not recognise a contract to enter into a contract (when there is a fundamental term yet to be agreed) ... it cannot recognise a contract to negotiate. The reason is because it is too uncertain to have any binding force. No court could estimate the damages because no one can tell whether the negotiations would be successful or would fall through: or if successful, what the result will be.”

By contrast to English law, continental systems empower the offeror to bind himself by an irrevocable offer. As Cohen explains, civil law systems empower the offeror to bind himself/herself by an irrevocable offer, if he/she so wishes. “Negative freedom in the negotiations is not sacred: even a non-contractual promise or a mere expectancy may have a certain binding force under the doctrine of good faith in negotiations”. Thus, in German law, unless the offeror by appropriate language has given fair warning to the offeree that the offer is not binding, any offer once communicated is binding. In France, an ordinary offer is revocable until accepted, but a firm offer is binding.

The following two sections (3.2.1 and 3.2.2) shall focus on the case of a sudden and unjustified rupture of negotiations.

3.2.2 Sudden and unjustified rupture of negotiations: Perspectives under the civil law

A sudden and unjustified rupture of precontractual negotiations by one party may also be deemed to be in breach of good faith, when the other party had good reason to rely on the future conclusion of the contract and had, for example, incurred some expenses in preparation of the fulfilment of its obligations. This is the opinion of Galgano (2000), writing on Italian law. This is also the case in a number of other civil law countries. In fact, Lando et al (2000) mention that the German Supreme Court has held a person liable if, without good reason, he refuses to continue negotiations after having conducted himself in such a way that the other party had reason to expect a contract to come into existence with the content which had been negotiated. They explain further that the same also applies in Austria, Belgium, Denmark, France, The Netherlands and Portugal.

A similar notion is also found in the Principles of European Contract Law drawn up by the Commission on European Contract Law under the chairmanship of Prof. Ole Lando (Lando et al, 2000), and in the UNIDROIT Principles of International Commercial contracts (UNIDROIT, 1994). The Principles of European Contract Law and the UNIDROIT Principles are neither treaties nor international conventions.

20 See German BGB, §145.

21 However, among the stated aims of the Principles of European Contract Law, is to suggest a modern European ‘lex mercatoria’, and to help bring about harmonisation of general contract law within the European Union. Of course, these Principles are also available for immediate use by individual contracting parties who may choose to
Article 2.301 of the Principles of European Contract Law starts with the general rule in sub-article (1) that “a party is free to negotiate and is not liable for failure to reach agreement.” This is identical to Article 2.15 (1) of the UNIDROIT Principles.

However, the Principles of European Contract Law then provide that a party who breaks off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party (Article 2.301 (2)). The UNIDROIT Principles contain a mirror provision in Article 2.15 (b) which however provides that a party who breaks off negotiations in bad faith is liable for the losses caused to the other party.

3.2.3 Sudden and unjustified rupture of negotiations: The common law position

In England, the basic principle of freedom of contract, and the absence of any legally relevant intermediate stage between contract and no-contract, often makes it difficult to identify a possible cause of action for breaches of good faith in the negotiation stage (O’Connor, 1990). In general, a party will not be held liable for breaking off negotiations. However, a remedy in tort for negligent misrepresentation may be available to the innocent party who relied on a negligent misstatement by the other party who led him to believe that a contract would be concluded, whereby the innocent party suffered loss and on the facts there was a special relationship between the parties (Lando et al, 2000).

Common law authors mention two other bases on which recovery could be made (i) by holding that a collateral contract had come into existence between the parties, (ii) by way of a claim for restitution.

The former was the basis for the decision in Brewer Street Investments Ltd v. Barclays Woollen Co. Ltd. (1954) and in Harvela Investments Ltd. v. Royal Trust Co. of Canada (Cl) Ltd. (1986). In Brewer Street, defendants were negotiating the lease of plaintiffs’ premises and, in the expectation shared by both parties that a lease would be agreed, defendants had requested that the plaintiffs have certain work done on the premises which was otherwise of no benefit to them. The defendants had, however, expressly undertaken that they would be responsible for the cost of this work. However, before the work was completed, it became clear that the lease would not be concluded. Plaintiffs stopped work and sued for the amounts which they had paid to the contractors in respect of the work carried out. The Court held there was a contract between the parties for the carrying out of the work on the premises, despite the fact that there was no contract of lease concluded. Recovery was granted on the basis of a contractual ‘quantum meruit’, i.e. a reasonable sum for the work done (which was set at the amount which the plaintiffs had paid their contractors) as the defendants had agreed to pay for the cost of the work.

The other possible basis for recovery is by a claim for restitution. This is the case where one party, upon request by the other party, carries out certain work which was not intended to be gratuitous but which was intended to be compensated for out of the profit which the former would have made out of the future contract, and this work benefited the other party (William Lacey (Hounslow) v. Davis, 1957). One here notes the element of unjustified enrichment.

Another solution offered by some common law jurisdictions is the rule of promissory estoppel which is a hybrid notion, comprising elements of contract (promise) and tort (reliance). This institution has been highly developed in the United States and Australia, but is of somewhat limited application in English law.

One thus notes that common law judges ingeniously provided a basis for recovery, without entering into the notion of good faith, by using the notion of collateral contact, restitution and the law of torts. Cohen (1995) postulates that the collateral contract and the tort of negligence currently serve as the main tools for imposing pre-contractual liability. As Furmston (1998) explains, whether or not common law courts ultimately embrace good faith, there is an inherent strength in the common law to police bad faith.

3.3 No real intention to contract

As a specific example of breach of good faith, the Principles of European Contract Law mention the case where a party enters into or continues negotiations with no real intention of reaching an agreement with the other party (Article 2.301(3)). The UNIDROIT Principles of International Commercial Contracts go one step further and clearly state that such behaviour constitutes bad faith.

subject their contract to these Principles. Similarly, parties may wish to subject their contract to the UNIDROIT Principles. See further on this, Lando et al, 2000.

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22 In civil law systems, the notion of unjustified enrichment is founded on good faith. For further discussion on restitution see Furmston et al, 1998 and Zimmermann et al, 2000.

23 According to this doctrine, sometimes known as ‘forbearance in equity’, where a person promises not to enforce a legal right against another person and the latter relies on this promise to his detriment, then the court may, if it is equitable to do so, prevent the promisor from going back on the promise.

24 Furmston et al (1998) were here referring to English and Australian common law.
Although legal systems may vary as to the scope of precontractual duties, generally, they do not permit one party to break off negotiations with impunity in pursuance of a scheme never to come to agreement. In civil law, a party who has used negotiations solely to induce the other party to take a desired course of action and then terminates them after his goal has been accomplished, will have to answer in damages to the party (Kessler et al, 1964).

This sort of behaviour is also likely to be proscribed in common law as fraudulent representation. As Furmston (1998) explains, “[s]uppose for instance it can be shown that the defendant never intended to enter into contract with the plaintiff and simply entered negotiations in order to deflect the plaintiff from negotiating with somebody else. Granted that one’s state of mind is a question of fact, this is capable of being a fraudulent representation.”

However, although such behaviour could also be proscribed in common law, this is not because of any duty to negotiate in good faith, but because it would be tortuous behaviour, i.e. fraudulent representation. Therefore, a party should be cautioned not to enter into or continue negotiations with no intention of contracting.

4 Concluding Remarks

This paper is the result of ongoing research on the role of good faith and fair dealing in contract. While the focus in this paper has been on the negotiation and contract formation stage, future work will focus on good faith in the execution of contracts.

Throughout this paper, one could note the marked difference of approach between civil law and common law jurisdictions. While the notion of good faith has effected contract law and is applied from the stage of contractual negotiation in most civil law countries, English and American jurists start from the premise that there is no general rule to negotiate in good faith. In these common law countries, piecemeal solutions have been developed to problems of unfairness. However, it has been shown that there are marked similarities in the behaviour expected of negotiating parties.

It is also important to bear in mind that electronic commerce transactions facilitate borderless trade and that negotiating parties may be located (i.e. resident, domiciled or established) in different jurisdictions. An important role is played by the applicable law that will determine a particular dispute because the rules and remedies may vary from one country to another. Nevertheless, efforts to identify standards for behaviour that are common in different legal systems, in order to then ensure that such behaviour is followed by one’s electronic agent, will help minimise risk of falling foul of national law. Or at least it is so hoped ...

References


**Court judgments**

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