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Good faith principle, compulsory behaviour of the parties during the precontractual agreement

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Abstract

The bona fide (good faith) principle requires party's reciprocal, including their duty to inform and collaborate. It should be part of the contract in all its stages, from its creation to execution. The upholding of this principle during the party's negotiation and in the establishment of the terms of the contract is a compulsory requirement aiming to protect and place the parties in equal footing with regard to the formation and execution of the contract. It serves to defend the party's interest so that it would not engage in irrelevant negotiations or improper and dishonest conduct which would jeopardise the normal development of the agreement. On the other hand, makes it possible for pulling out of the negotiations if convinced that the contract would be of any benefit to him. A just balance needs to be struck between these two competing interests in order to consider whether the pulling out of negotiations will be treated as an illegal conduct will account for conditions that were known or ought to have been known if he paid reasonable attention which will make impossible the entering of the contract, or has that party been undecided due to the other party's behaviour which would not bring any precontractual responsibilities for the party pulling out.

Keywords: Good faith principle, compulsory behavior, the precontractual agreement

1. General profile

During the precontractual stages of a contract any of the parties involved is free to look into the benefits it will be able to get from the contract and has the full right to inspect as to what are the potential benefits it will gain by entering into an agreement. This is a right directly related to the freedom that any of the parties can withdraw from the negotiations as soon as it finds to have no reasonable interest to enter into a contract. The only limitation to this rule is that the party retreating from negotiations should do so in good faith.

The doctrine of "good faith" is a general notion that applies to many legal and judicial acts. It is important to acknowledge that almost all private international law instruments make references to the good faith doctrine.[1] However, there is no agreement, among those countries that recognize it,

[1] United Nations Convention on Contracts for the International Sale of Goods, Vienna, signed 11 April 1980, entry into force 1 January 1988, 1489 UNTS 3, Article 7.

as to what exactly constitutes its core principle.[2] Good faith principle demands the parties during the precontractual stages to avoid damaging their mutual interest. Part of this obligation is also the duty to inform and act in a way which is harmonious with their contractual intentions. This is especially required where through words or action one of the parties has raised the other party's expectations to the agreement. So, good faith requires more than just honesty[3] or reasonableness; as it also requires affirmative acts and fair dealing.

In order for the parties to have responsibility for precontractual agreement it is necessary for them to have entered talks and negotiations although the contract has not been entered into or its conclusion is unlawful. Although the term parties is used for precontractual and contractual agreement simultaneously, giving the impression of a contractual relationship, the interest of fairness demands for a good faith relationship long before the conclusion of the contract. For responsibitlity to arise it is necessary for the party calling on the other to negotiate to have acted or behaved in a way that made the other believe that he is ready to enter into the contract.

Good faith is believed to enhance economic efficiency, as it helps reduce costs during contract negotiations.

The Civil Code does not even clearly define if the principle of trust in the pre-contractual phase refers only to the offer and acceptance, as two main links in the formation of a contract, of which the law has expressly recognized the consequences, or even simple invitation to treat or negotiations. The statement of offer is the final statement of an individual who wishes to be bound by those terms;it is a person's final declaration of his readiness to be bound. If an individual is not willing to implement the terms of his promise but is merely seeking to initiate negotiations then this can not amount to an offer, such statements being termed "invitations to treat". The distinction between an offer and an invitation to treat is not an easy one to make since it very often revolves around that elusive concept of intention.[4] When displaying goods for sale, either in shop windows or within a shop itself, by the civil law legislation such cases are treated as offers, while in the common law they are only invitations to treat. If the diplay of goods only amonts to an ivitation to treat then it is the customer who makes the offer to the shopkeeper, who is free to accept or reject that offer as he wishes.[5] Lord Parker stated: "It is clear according to the ordinary law of contract that the display of an article with a price on it in a shop window is merely an invitation to treat. It is in no sense an offer for sale, the acceptance of which constitutes a contract." In the case of the advertisements and other notices - most of them do not fall into this category and hence they are held not to be offers but statements of inviting further negotiations or invitations to treat.[6] As a conclusion, generally speaking, the common law system is more commercially oriented. Its focus is on justice in each particular situation, and it tends to favor commercial certainty over justice.[7] English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated

[2] Richard Hooley, *Controlling contractual discretion*, 2013 C.L.J. 65, 74.
[3] Gerard Mantese, *Still keeping the faith: the duty of good faith revisted*, 76 Mich. B.J. 1190, 1190 (1997).
[4] Law of Contract, Paul Richards,sixth edition, 2004, page 16
[5] Fisher v Bell, 10 November 1961, Queen's Bench Division
[6] Partridge v Crittenden [1968] 1 WLR 1204
[7] Disa Sim, *Scope and application of good faith in the convention on contract for the international sales of goods*, 2003 Rev. Convention Cont. For Int'l Sale Goods 19, 9. (available athttp://www.cisg.law.pace.edu/cisg/biblio/sim1.html#)

problems of unfairness.[8]Although the US is a common law system, it also recognizes a duty of good faith. US Courts have stated that "[e]very contract implies good faith and fair dealing between the parties to it."[9] Civil law systems, on the other hand, focus more on consent and the moral behavior of the parties. In a recent case, *Yam Seng v. ITC*,[10] was related a claim for breach of contract and misrepresentation brought by a distributor in Singapore, YSP, against an English supplier, ITC. Justice Leggatt decided that parties should perform commercial contracts in good faith, when that is the expectation of the parties. He stated that: "…the basis of the duty of good faith is the presumed intention of the parties and meaning of their contract, its recognition is not an illegitimate restriction on the freedom of the parties to pursue their own interests. The essence of contracting is that the parties bind themselves in order to co-operate to their mutual benefit. The obligations which they undertake include those which are implicit in their agreement as well as those which they have made explicit."

This decision is important because in arriving to his conclusion Justice Leggatt studied English case law and determined that it does not fundamentally reject the use of good faith and fair dealing. He also stated that different figures in English law protect the same principles as good faith; such as honesty, reasonableness, and protection of reasonable expectations, among others.

Precontractual obligation includes not only the recognised concepts of offer and acceptance as negotiating terms but also any other action or behaviour from one of the parties which makes the other reasonably believe on the likelihood of the conclusion of the contract. The party inducing the other which owes the duty to act in good faith will have to pay for damage caused to the induced party.[11]. As an example, during contracting which proceeds incrementally, parties cannot ex ante fully determine the "price" of the exchange, because they usually lack the information to do so. Therefore; if the buyer commits himself to buy, he necessarily has to rely on the seller's reciprocal commitment to sell when he specifically invests his resources in the further development of the contracting process. In this context, the seller is in a stronger bargaining position, as he not only has the real estate, but also all the relevant information, on the basis of which the potential buyer grounds his acquisition decision. On the other hand, the buyer is more vulnerable towards opportunistic behaviour, as he necessarily has to undertake highly specific investments in the preliminary phase, in order to be in the position of making an informed decision. Due to the asymmetry of specific investments in the pre-contractual phase, the weak contractual party has to face, at most, the risk of being subjected to the typical hold-up problem, as the stronger contractual party might have an incentive to exploit the bilateral dependence in order to expropriate the rents accruing to the specific assets.[12]

Irrespective of the length of the talks or the frequency of meetings between the parties, an unjustified breaking of the talks from one party would be considered a breach of trust on the other party who was led to believe on the conclusion of the contract. Pulling out from the talks at this point would make the party doing so responsible for precontractual damages. When contractual parties are holding talks regarding the adjustment of one or several provisions within the contract, or have come to a partial agreement, it can not be inferred that we have a contract as

[8] Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd , *Id*, at 439.
[9] Wigand v. Bachmann-Bechtel Brewing Co., 222 N.Y. 272, 277 (1918).
[10] Yam Seng v. International Trade Corporation, Ltd [2013] EWHC 111 (QB)
[11] Codice civile Annotato con la Giurisprudenza, XI Edizione, Luciano Ciafardini,Fausto Izzo, 2008
[12] "Safeguarding Specific Investments in Real Estate Purchases", Cristiana Cicoria and Christoph H. Niehus, Global Jurist, Volume 7, Issue 1, ISSN (Online) 1934-2640, DOI: 10.2202/1934-2640.1223,

any agreement at this stage is considered to be inconclusive. Therefore there cannot be a precontractual responsibility for damages. In order for the negotiations to be treated as contractual it is necessary that the parties to have been presented with the respective fundamental elements of the contract. The best way is to look at all the respective documents passing between the parties and glean from them or from the conduct of the parties, whether they have reached an agreement on all material points[13] and to do so it must be looked at their correspondence as a whole[14].

If one of the parties knew or ought to have known the cause for invalidity of the contract and has nevertheless failed to inform the other party, it will be held responsible for all the damages the other party has incurred from honestly believing that the contract would be concluded.

In contrast from the first example of precontractual responsibility, the duty owed from the party here is not for making the other believe that the contract would be concluded, but rather for making it believe that it would be valid.

The damages that will have to be paid in this circumstances include losses suffered, expenses paid for the negotiations and loss of profit incurred due to rejecting offers made from other party but it does not include the amount that would be earned had the contract been concluded.

The notion of precontractual responsibility would be equally applicable either for unjustified breaking of the contractual negotiation or due to misleading or incorrect information given from one party for prearranged contracts. Meaning contracts prepared from one party and simply accepted from the other.

2. Good faith principle during precontractual arrangement and public administration

Precontractual responsibility of the public administration is present in all those cases where the public body during the negotiations has acted discordantly or delivered any contradictory statement contrary to good faith principle. It is for the judges to be attentive to the existence of any sort of precontractual responsibility. This kind of responsibility from public bodies is often noticed in public tenders. In those procedures if the public body has made a public invitation for an illegal tender causing the party to enter its bidding reasonably believing in the validity of the offer and procedure and therefore raising anticipations that the contract would be completed, it will be held responsible for breaching its duty of good faith[15]. As the final controller for the execution of the law from public bodies it often is left to the court to discover the responsibility of the public body through a judicial review process.

Tenders are another kind of statement which is considered as an offer in civil law, while in common law it is considered that a statement that goods are to be sold by tender is not normally an offer, and that thus no obligation is created to sell to the person making the highest tender[16]. Here the person requiring or selling the goods makes an ivitation to tender, the person wishing to deliver or buy them making the offer, which will be converted into a trading contract when

[13] Butler Machine Tool Co. Ltd. v Ex-Cell-O Corporation Ltd. [1979] 1 All ER 965
[14] Gibson v Manchester City Council [1979] 1 All ER 972
[15] Case no. 16898, (21 July 2010) Regional Administrative Court of Campania, Italy
[16] Case Law, Spencer v Harding (1870) LR 5 CP 561

accepted by the first party. In recent years a new development has occurred in the area of tender even in common law, namely, the referential bid.

3. Remuneration of the damages

Breach of fiduciary duty in the precontractual stage will make the offending party responsible for all the immediate and direct damages caused as result. The debt owed as result of the damage caused will include the interest lost together with the actual damage caused. It will also include expenses incurred during the negotiations and loss caused from missed opportunities to enter into an agreement with other parties in more favorable and profitable conditions. It will not however include lost profit suffered due to not accepting other offers to enter a contract. It will be assessed not on the basis of the earnings lost as result of non completion of the contract but only losses which were suffered from timewasting negotiations. In order for damages to be granted on the basis of a breach of the fiduciary duty, a causal link must be proven on the balance of probability, that the damage is the direct result of the actions or omissions of the breaching party. In a case regarding payment of damages caused an public body with retreating from negotiations without justifiable cause the Italian Administrative Court states with some degree of clarity what losses can be awarded. In deciding the case the Italian Court has included only effective damages, expenses incurred but not the lost profit due to lost opportunities, since the other party could not prove that this opportunities were lost due to it being engaged in tendering negotiations with the public body. The court was also helped from other particular circumstances such as the pulling out of negotiations from the public body was not prolonged unnecessarily. It had also indicated early on their dealing that the tender was to be given to some other bidder on the basis of documentations submitted. Other than expenses for preparation of materials submitted the court also added to those expenses the employee costs. It granted five hours paid work for every employee involved in the preparation of the tendering documents, another five hours for those taking part in the inspection of tendering documents and another ten hours granted to those who were tasked with the preparation of the tender.

4. Subjective Terms

In order for the party to be held responsible under the subjective terms it must be proven that it has behaved in bad faith in a way that, after raising the other parties belief and inciting it to make expenditure, or refuse other more favorable offers on the belief that contractual agreement would be finalised. In order to succeed with its claim the wronged party must prove that the other knew or ought to have known from the circumstances and also that itself honestly and reasonably believed that the contract would be concluded From the foregoing of this analysis it is necessary that the parties must work closely and continuously inform one another. Avoiding misrepresenting statements or deed will not suffice, they must also collaborate and continuously communicate all information which may affect the terms of the contract. Other predictions are noticed under English law where the general rule is that mere non-disclosure does not constitute misrepresentation, for there is, in general, no duty on the parties to a contract, or on potential parties to a contract, to disclose material facts to each other, however dishonest such non-

disclosure may be in particular circumstances. There are exceptions to this general rule, notably contracts within the class of contracts *uberrimae fidei*, and contracts where there is a fiduciary relationship between the parties, and finally, where failure to disclose some fact distorts a positive representation that has been given.[17] In *Caparo Industries plc* v *Dickman* [1990] 2 A.C. 605, it was held that (to quote the headnote) "liability for economic loss due to *negligent misstatement* was confined to cases where the statement or advice had been given to a known recipient for a specific purpose of which the maker was aware and upon which the recipient had relied and acted to his detriment...". In case of a *Negligent misstatement* is a category of tort within the tort of negligence[18]. While, a person to whom *a fraudulent misrepresentation* has been made, and who enters into a contraction the basis of that representation, is also entitled to rescind the contract. Damages for fraud are not designed, as in the case of contract, to place the innocent party in the position in which he would have been had the representation been true; rather they are designed to put him in the position he would have been if the representation had not been made. The net result of this is that the representative ought to be awarded such damages as would put him back in the financial position he was in before the contract was made[19]. For an *Innocent misrepresentation* that is neither fraudulent nor negligent, the general rules remains what it has always been, namely that no action for damages lies for a mere innocent misrepresentation. Rescission is available for all types of misrepresentation.

5. Conclusion

In principle, Albanian law supports freedom of negotiations, although this is subject to the overriding obligation to act in good faith. This obligation affects the way negotiations are carried out and the way they are terminated (prohibiting parties from walking away from the negotiating table at a critical stage in their discussions "abusively" or without legitimate reason). Parties will be particularly vulnerable to claims of "abusive breaking off of negotiations" (*rupture abusive de pourparlers*) if negotiations have been lengthy (i.e. with a real likelihood that they will lead to a binding agreement) or where they pull out of discussions without warning or where there are no other aggravating circumstances. The duty to negotiate in good faith applies automatically under Albanian law, whether or not it is expressly included in a letter of intent or other pre-contractual agreement. The same predictions are available even in the other civil law countries. But, since different jurisdictions have different rules relating to pre-contractual negotiations, it will be important to clarify from the beginning which country's laws will apply, seeking advice where necessary. In conclusion, good faith is a general principle that can be found in any type of legal jurisdiction. However, there are differences as to its application. Civil law jurisdictions interpret their obligations law in accordance with this good faith and fair dealing principle throughout its entire process. Common law, specifically English, jurisdictions are more reluctant to permit its application in any type of contract. Nevertheless, more recent developments in English law suggest that courts may begin to apply this doctrine in contract interpretation more frequently. These differences are in terminology, in many occasions, as they still reach the same result. Both

[17] "Misrepresentation and negligent misstatement,a very brief guide", Graham Penn, Philip Rawlings, UCL Faculty of Laws
[18] *Hedley Byrne & Co.* v *Heller and Partners Ltd.* [1964]A.C.465
[19] *Doyle* v *Olby (Ironmongers),* Court of Appeal in *Limited* [1969] 2Q.B.158.

systems try to protect some of the same principles, whether by good faith or equity, that lead to a fair interpretation and/or solution. Since precontractual responsibility is an ever evolving process, the establishment of a general principle from the court becomes necessary. Good faith principle imposes responsibility obliging each party to take into account the interest of the other even if that interest is not directly covered from the contract law or any other type of law. Companies should make sure they consider the duty throughout negotiations and seek advice where necessary. If, for example, a company intends to conduct parallel negotiations with a number of parties or solicit competing offers, it may need to make this clear to all the parties concerned. Companies will also need to take care if it becomes clear to them during negotiations that a final agreement will never be reached, as they could be considered to be at fault if they prolong the negotiations artificially[20]. Parties should avoid giving the impression that an agreement has been all but reached, if this is not the case. To safeguard their position, parties should aim to make sure that outstanding conditions are in place throughout the negotiations and that the other party has a written reminder of these conditions at regular intervals. The conditions might include open due diligence items, internal or regulatory approvals required, or terms of the deal itself. In the event of a claim for breach of good faith, objective conditions will carry more weight than conditions within the control of the relevant party, which may not be effective. The implementation of many of the international private law instruments may nudge English law towards that broader interpretation, by using harmonization to expand this doctrine. Which ultimately demonstrates that, despite the differences between systems of law, contracting in good faith is becoming more of an international norm that will be found in many different types of contracts, regardless of their judicial traditions.

[20]http://www.olswang.com/articles/2013/11/ocq-autumn-2013-french-duty-to-negotiate-in-good-faith/