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**PRE-CONTRACTUAL LIABILITY: PROTECTING THE RIGHTS OF  
THE PARTIES ENGAGED IN NEGOTIATIONS<sup>2</sup>**

1. *New trends in development of contract formation procedures*

The main trend of contract law progress is its development from the maximum formalization (when the primordial agreements could be entered into only by means of stipulation, i.e., when the agreement was considered to be properly made only if certain specific phrases were uttered by both parties) through the maximum flexibility and informality (when the modern agreements can be entered into via Internet). There was a time when agreements were concluded relatively rarely and were considered to be only an auxiliary tool helping people to reach the economic outcome they needed. As time passes, agreements are becoming the most widespread regulative tool moving goods, services and work and, in fact, the modern commercial market is primarily based on agreements. Contemporary contract law is inevitably and deeply influenced by the commercialization of modern private law, flexible and receptive to the demands of the market and ready to borrow concepts from private international law and other legal systems.

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As one of the inevitable and logical results of development of contract law, the procedure for entering into contract has also been modified, becoming, on the one hand, more flexible and, on the other hand, more complicated and less standardized (and thus more manifold). As the number of contracts and their variety grow, the commercial market starts demanding that the law develop simpler, quicker and at the same time more reliable procedure for entering into contracts. Not only does the old stipulation or mancipation used by Roman law not suit the needs of the developing commercial market, but even the classic procedure for entering into agreements that has been used for centuries by all legal systems – i.e., making an offer and its acceptance – does not meet the requirements posed by the market as being too complex and formal.

Another factor that adds to the dissatisfaction with the classic procedure for entering into agreements is that it does not always hold up to the specifics of the modern contract-making process in respect of very complex agreements that involve big amounts of money. Such contracts are usually entered into in the process of long negotiations that may last for years, when the parties reach an agreement by piecemeal. “In practice the procedure for entering into agreements is frequently much more complicated [than a simple exchange with an offer and acceptance]. Offers and counteroffers criss-cross in such a way, that the ultimate agreement is reached only at the end of discussion. In the process of such discussion, the body of the agreement is developed.... [In addition,] the technical progress affects the contract formation procedures as well and leads to the evolvement of the contract-making process from the classic contract formation procedure [by means of exchange with offers and

acceptances] into long negotiations concerning various contract provisions”.<sup>3</sup> To understand how the modern contract formation procedure differs from the classic one, let us go through a couple of examples.

It is common that the general understanding regarding the most fundamental provisions of the future agreement is reached during the negotiations at the highest level (between CEOs of the companies), while all minor details are left for negotiation and drafting by the lawyers of both parties. The lawyers may spend weeks and months exchanging drafts and modifying and perfecting every other word and paragraph in the draft agreement. When both parties seem to run out of suggestions, the master copy of the agreement is initialized by one party and passed over to the other party. Upon initialization by lawyers of both parties, the agreement is executed by authorized persons acting on behalf of each party.

Another example of a modern contract-making procedure: Company X that is interested in entering into an agreement with Company Z, sends to Company Z an invitation to discuss the possibility of entering into the agreement and solicits from Company Z the principal terms and conditions of such agreement. Having considered the principal terms and conditions received from Company Z, Company X suggest meeting with Company Z and discussing certain terms. In anticipation of such meeting Company Z, wishing to add to Company X’s willingness to enter into the agreement, suggests amending certain terms and conditions. During the meeting, both

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<sup>3</sup> *Rone Savatier* La Theory des Obligations. M. 1972. P. 184.

parties amend the suggested terms once again and finally work out a mutually acceptable draft.

One more example of a modern contract formation procedure: the parties embark on negotiations without even preliminary exchange of principal terms and conditions of the future agreement, and work out the body of the agreement sitting across the table, in the course of lengthy oral negotiations.<sup>4</sup>

In either of the above cases, it is hard, if at all possible, to say which of the parties made an offer, when such offer was rejected and a counter-offer was made. “During the negotiation of such deals there is often no offer or counter-offer for either party to accept, but rather a gradual process in which agreements are reached piecemeal in several “rounds” with a succession of drafts”.<sup>5</sup> It is also difficult to establish which of the messages and suggestions the parties are bombing each other with have any legal effect imposing certain obligations and granting certain rights to the author or addressee of such message, and which messages amount to a simple exchange of thoughts and ideas with no legal effect attached thereto. In other words, in either of the above cases, the parties find themselves being engaged in the contract formation procedure for which no special and adequate rules are established in most legal systems.

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<sup>4</sup> *Michael Rozenberg* Formation of Contract for International Sale of Goods. M. 1991, P. 9-10.

<sup>5</sup> *Alan Farnsworth* Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations. 87 Colum. L. Rev. 217; see also *John Klein* and *Carla Bachechi* Precontractual Liability and the Duty of Good Faith Negotiations in International Transactions. 17 Hous. J. Int'l L. 1.

In addition to (and to a certain extent as an inevitable consequence of) the impossibility to define which of the messages the parties exchanged with should qualify as an offer and/or acceptance, a problem arises as to whether the agreement has altogether been concluded and when it was concluded,<sup>6</sup> as well as what the terms of the agreement are, if such is concluded. These problems are more likely to lead to an argument between the parties than when the classic procedure of contract formation applies (even if the parties fail to execute a single document that would incorporate all contract provisions when entering into the agreement by means of classic exchange with an offer and acceptance), because when conducting negotiations the parties reach understandings on various terms and conditions of the future agreement by pieces, gradually, coming back to what has already seemed to be agreed, etc. – so that when the negotiations are over, a question arises – so, well, what have we agreed on?

If the agreement has not been reached for any reason (and especially if one of the parties perceives such failure to be due to the fault of the other party), questions may arise as to (i) whether the parties acted in good faith when conducting negotiations (and whether they were under an obligation to act in good faith), (ii) whether the party that committed a certain amount to the contract formation process or has already begun performance of the yet-to-be-concluded agreement may recover

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<sup>6</sup> “A contract may be concluded as a result of lengthy negotiations followed by the agreement of parties’ wills...It is sometimes difficult to judge when such final agreement of wills has been actually reached down the long way that starts when the parties first mentioned the possibility of entering into the agreement and lasts through the moment the negotiations are finalized”. *Pobedonostsev K.P.* Civil Law Course. P. III. M. 2000. P. 110.

such expenses from the other party, (iii) what is the legal nature of the preliminary agreements executed by the parties in the course of the negotiations and whether such preliminary agreements impose any binding obligations on the parties, etc. All these questions remain unanswered if we rely solely on the classic procedure for contract formation. The issues that the classic contract formation procedure is concerned with (what are the mandatory criteria the offer should comply with, whether the acceptance may include any provisions that differ from those included in the offer, whether and up to what moment the offer may be withdrawn or revoked, etc.) are of no importance when the agreement is concluded in the course of negotiations and are superseded by other issues as discussed above. Therefore, developing the rules regulating this new procedure for contract formation becomes a challenging assignment for all legal systems.

## 2. Venturesome theory of negotiations

At the pre-contractual stage the parties are usually not bound by any agreement regarding the procedure for contract formation. It has always been conventional that the contract formation procedure is informal and based on usages and ethical rules established in a particular business community. Therefore, the law initially abstained from interfering with the contract formation procedure and did not impose any obligations on the parties as to the manner in which such negotiations should be conducted. The only contract formation procedure that with the passage of time the law came to recognize was the classic procedure (by means of making an offer and its acceptance). As concerns the procedure for contract formation through negotiations, for a long time the law remained completely silent.

This approach was based on a so-called *venturesome* [aliatory] theory of pre-contractual process that commands that each party should bear its own risks associated with negotiation of the contract.

There are three basic assumptions on which the venturesome theory of negotiations is built. The first assumption is that any interference with the contract formation procedure, when the parties have not yet undertaken any contractual obligations yet nor performed any tort, will result in a violation of the freedom of contract principle that has always been a core principle of contract law.

The second assumption is that any interference with contract formation procedures before the parties agree to be subject to any binding obligations or before they perform any tort, will make the parties think twice before embarking on negotiations and would thus be a deterrent that would lead to an overall reduction in the number of contracts. However, economic studies have earnestly proved that not only will such interference not be a deterrent, but it can actually result in the growth of the number of contracts, as the parties to the negotiations would know the game rules and would thus feel more comfortable and confident when commencing negotiations.<sup>7</sup>

The third assumption on which the venturesome theory is based is the principle that unless the parties' behavior falls within the scope of the established formal rules and procedures, it should be ignored as legally indifferent. However, as discussed above, the general trend of development of modern law from maximum

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<sup>7</sup> *Bebchuk Lucian Arye, Ben-Shahar Omri* Pre-contractual Reliance. Harvard L. School. 1996.

formalization towards maximum flexibility and receptivity to the market demands applies in full to the contract formation process as well. The more versatile contract law becomes, the less formal the contract formation procedure becomes. The law becomes more lenient in establishing mandatory requirements that the offer and acceptance have to meet.<sup>8</sup> The law also starts paying more attention to the parties' actions before the offer is made and gradually comes to recognize contract formation procedures that are alternatives to the classic procedure, such as contract formation in the course of negotiation.

Therefore, with the passage of time and development of the commercial market, all three assumptions on which the venturesome negotiations theory is based lost their persuasiveness and importance. It becomes clear that the aloofness of the law from governing parties' relations at the pre-contractual stage may lead to unfair results and does not accommodate the social destination of contract.<sup>9</sup> Therefore, modern law faces the need to address market demands by a means of overriding the venturesome negotiations theory, recognizing negotiations as a separate contract formation procedure and establishing special rules governing parties' relations in the

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<sup>8</sup> For example, instead of requiring that the offer reflects both the intention to enter into the agreement and all terms and conditions of the future agreement, nowadays the law is paying primary attention to the intention of the offeror to enter into the agreement even though the offer might fail to articulate all terms and conditions of the future agreement. Contemporary law in certain cases allows the acceptance to incorporate some terms and conditions that differ from those included in the offer. The most radical deviation from the classic theory that the acceptance should simply mirror the offer is suggested in the U.S. Uniform Commercial Code §2-207. See also *James J. White and Robert S. Sommers Uniform Commercial Code*. 3-rd ed. St. Paul. Minn., 1988. P. 32. A relaxation of the "mirror" theory can also be seen in the revised German Civil Code (§150 and §154-155).

<sup>9</sup> *Friedrich Kessler and Edith Fine Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: a Comparative Study*. 77 *Harvard Law Rev.* 3 (1964). P. 407.

course of negotiations. In other words, modern contract law needs to find a balance between, on the one hand, the need to protect the rights and interests of the parties entering into negotiations and, on the other hand, the need to observe the freedom of contract and not to create excessive impediments for the parties wishing to negotiate and enter into the agreement.

Different legal systems perceived the need to interfere into the negotiations process at a different point in time. The venturesome negotiations theory was especially strong in common law legal systems (under the influence of this theory, the common law for a long time refused to establish whatever rules governing the parties' relations at the pre-contractual stage). However, at present, all legal systems, including common law legal systems, recognize the need to govern pre-contractual relations and contract negotiations.

Due to the diversity of contract negotiations techniques and methods, as well as the ways of putting together the understandings reached in the course of negotiations, such techniques, methods and ways cannot be so easily unified and formalized as the classic contract formation procedure. Therefore, many legal systems, instead of working out detailed provisions that would govern this new contract formation procedure, decided in favor of establishing only general principles of pre-contractual behavior (including the general duty of good faith) and imposing pre-contractual liability for failure to observe such principles. Thus, the answers to most questions arising in connection with this new contract formation procedure (including, for example, the admissibility of breaking negotiations and opting out of further negotiations, the possibility to recover damages caused by one party to the

other in the course of negotiations, etc.) should be drawn from these general principles, including, in the first place, the core principle of fair negotiations.

### 3. Origin and development of pre-contractual liability

As discussed above, all legal systems are moving in the same direction of imposing on the parties the obligation to behave fairly when conducting negotiations; violation of such obligation leading to imposition of pre-contractual liability. At this, the duty of good faith, being a base component of the bulk of regulations governing negotiations, gradually came to apply to the classic contract formation procedure as well (for example when unfair conduct of one of the parties preceding acceptance of the offer mislead the other party and resulted in the invalidity of the agreement concluded under such undue influence).

As the idea brand new for the law, pre-contractual liability (*culpa in contrahendo*), i.e. the liability imposed for undue behavior at the pre-contractual stage, started its development *extra legem*, at the level of court practice and business usages, and only relatively recently, in the fall of the twentieth century, found its way into the legislative acts and regulations.

The German legal system was the most receptive to the idea of pre-contractual liability. The first one to point out the need to introduce the concept of pre-contractual liability for failure to observe the fair conduct (good faith) rule, was the German lawyer Rudolf von Iering. In his treatise dated 1861<sup>10</sup> he evolved the *culpa in*

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<sup>10</sup> *Rudolf von Iering Culpa in Contrahendo, oder Schädenersatz bei nichtigen oder nicht zur Perfection gelangten Verträgen// Gesammelte Aufsätze aus den Jahrb\_cher f\_r die Dogmatil des heutigen romischen und deutschen Privatrechts, I. (1881).*

*contrahendo* theory that existed in a very limited scope in Roman law, worked out the grounds for pre-contractual liability and divided them into the following groups:

- one of the parties appears to be incapable of entering into the agreement;
- the agreement cannot be performed;
- the will of one or both parties when entering into the agreement is defective.

In the first case above it is assumed that the party embarking on negotiations should have known whether or not it could eventually conclude the agreement. If it was incapable of entering into the agreement, it should have notified the other party thereof, so as not to mislead the other party as to the possibility of having the agreement concluded.<sup>11</sup>

The second ground for pre-contractual liability applies when the contract is impossible to perform and such impossibility existed at the time the contract was entered into. Pre-contractual liability is imposed on the party that knew or should have known about such impossibility and failed to inform the other party thereof, thus creating an illusion of the legality and enforceability of the agreement.<sup>12</sup>

The third ground for pre-contractual liability comes into play when the will of the party to enter into the agreement was defective. If the other party was unaware of

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<sup>11</sup> This ground for pre-contractual liability does not apply if a party is incapable of entering into the agreement due to a lack of legal capacity (otherwise imposition of such liability would contradict the rules applicable to incapable persons).

<sup>12</sup> For example, this type of pre-contractual liability is set forth in the German Civil Code (§307).

such defects in the will of the first party, the first party should compensate the other for any damages caused as a result of the invalidity of such agreement.

Unlike the first ground for pre-contractual liability that applies when the agreement cannot be entered into, the second and the third grounds for pre-contractual liability apply in cases in which the agreement has already been concluded but, due to certain factors, turned out to be void. Therefore, von Iering was the first to draw a distinction between two types of pre-contractual liability.

The first type of pre-contractual liability is imposed when the agreement has already been concluded but was thereafter invalidated due to improper behavior by one of the parties during the contract formation process. For example, a party that mislead the other party or deceived the other party shall compensate for damages caused to the mislead or deceived party as a result of invalidity of the agreement.<sup>13</sup> A separate sub-type of this type of pre-contractual liability is the liability imposed on the party deviating from taking certain formal steps required for the contract to come into force or be considered concluded. Both parties have already expressed their will to have the agreement concluded but the unwillingness of one of the parties to perform certain formal actions prevents conclusion of the agreement. For example, if the agreement needs to be registered with a notary public or in any state or other register and one of the parties deviates from such registration, the law of most countries considers such deviation to be unfair behavior that may lead to the imposition of pre-contractual liability. Some legal systems also allow the other party to file a suit in

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<sup>13</sup> Civil Code of the Russian Federation, Arts. 178 and 179; German Civil Code, §122.

court claiming compulsory registration of the agreement<sup>14</sup> or deprive the party deviating from registration from the right to claim invalidity or non-conclusion of the agreement due to the lack of its registration.<sup>15</sup>

Unlike the first type of pre-contractual liability that is imposed when the agreement has already been concluded but was subsequently invalidated, the second type of pre-contractual liability is imposed when unfair behavior of one of the parties at the pre-contractual stage leads to the failure to enter into the agreement. This type of pre-contractual liability has for a long time been debated about as encroaching on the freedom of contract principle and is thus inadmissible. Therefore, unlike the first type of pre-contractual liability, the second type could not find its way into the legislation and court practice for quite a long time.<sup>16</sup>

However, with the passage of time and development of the market, pre-contractual liability theory evolved and came to embrace situations in which the agreement had not been concluded due to improper behavior of one of the parties during the contract formation procedure. Thus, a well-known French lawyer, Saleilles, in the beginning of the twentieth century suggested applying the “fair conduct”, or good faith principle (and liability resulting from the failure to observe this principle)

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<sup>14</sup> E.g., this approach is adhered to by the Civil Code of the Russian Federation (Art. 165).

<sup>15</sup> E.g., this concept is employed by the German Civil Code. See *Friederich Kessler* and *Edith Fine*. Op. cit. P. 416.

<sup>16</sup> *Omalu Mirian Kene* Legal Implications of Precontractual Agreements in Energy and Natural Resources Industries. <http://www.dundee.ac.uk/cepmp/journal/article2-10.html>.

to the entire pre-contractual process.<sup>17</sup> In accordance with this principle, the parties embarking on negotiations should act fairly and cannot terminate negotiations without due cause. Thus, pre-contractual liability becomes based on the general “basic thesis that from the moment the parties start negotiations, a special relation between them is established – relation of trust that requires reciprocal fairness on each party’s side”.<sup>18</sup> “Such general ‘assumption of fairness’ deserves special protection because it guarantees normal development of business.”<sup>19</sup>

#### 4. Legal qualification of pre-contractual liability

Various legal systems differ in how they sense the “fair negotiations” principle. The difference rests primarily in how to qualify pre-contractual liability and how to incorporate it on the legislative level.

There are two principal ways of embodying pre-contractual liability in legislation: legal systems either (i) establish the general obligation of fair negotiations (good faith duty at the pre-contractual stage) or (ii) set forth special provisions prohibiting some particular types of unfair negotiations. In the former case a positive obligation of fair negotiations is imposed, while in the latter case parties’ behavior at

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<sup>17</sup> *Saleilles* De la responsabilite precontractuelle, 6 Revue Trimestrielle de Droit Civil 697 (1907).

<sup>18</sup> *Ketz Hain, Lorman Frank* Introduction into Law of Obligations// Problems of Civil and Commercial Law of Germany. M. 2001.P. 61.

<sup>19</sup> *Alexander Komarov* Responsibility in Commercial Market. M. 1991. P. 47.

the pre-contractual stage is governed by means of establishing liability for particular types of unfair negotiations (negative regulation).<sup>20</sup>

As concerns qualification of pre-contractual liability, there is again no unity among various legal systems. Pre-contractual liability is qualified as: (1) contractual or quasi-contractual liability imposed for breach of the implied agreement to act fairly at the pre-contractual stage (e.g., this position is adhered to by German and English law); (2) tort liability (e.g., in French law); or (3) liability for breach of a promissory estoppel (common law systems). At this, nor legal system yet to work out a solid position on how pre-contractual liability should qualify. However, none of them qualifies pre-contractual liability as a separate type of liability, different from contractual (or quasi-contractual) or tort (or quasi-tort) liability. Therefore, the term “*pre-contractual liability*” applies to emphasize only the stage at which a violation occurred (pre-contractual stage) rather than the special nature of such liability.

Roman law qualified pre-contractual liability (*culpa in contrahendo*) as a special type of contractual liability. Roman law recognized two grounds for imposing pre-contractual liability: sale *res extra commercium* and sale of non-existent inheritance. In both cases Roman law adhered to a position that invalidity of such

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<sup>20</sup> “There is a contrast between, on the one hand, a normative role of requiring conduct to reach a particular community standard, and, on the other hand, a role of prohibiting certain conduct which is recognized as not being acceptable to the community”. *Furnston M., Norisada T., Polle Jill Contract Formation and Letter of Intent*. Hichester. 1998. P. 313.

agreements did not entail the impossibility of using all elements of the agreement, in particular, liability arising out of such agreement continued to apply.<sup>21</sup>

Unlike in Roman law, in some legal systems (e.g., in French law) pre-contractual liability is qualified as tort liability.<sup>22</sup> This theory emerged in the early twentieth century. Indeed, the thought that a person who acted improperly and thus caused damages to the other person should be held liable for tort – is the most obvious thought that comes in mind. However for pre-contractual liability to be qualified as tort liability it should meet the following criteria (which in most cases it fails to meet). First, such liability may be imposed only for at-fault actions. Second, the defendant's behavior at the pre-contractual stage should be violative of established mandatory rules (which, as discussed above, most legal systems are reluctant to establish in respect of pre-contractual relations).

Certain legal systems do not qualify pre-contractual liability as tort liability because of the specifics of tort law in such legal systems. For example, English law recognizes only certain types of torts. “Under the English legal system of nominate torts, the claimant must find a tort which meets his needs. For pre-contractual liability, the most obvious candidates are those of fraud and negligence. Fraud (or deceit) is very difficult to prove in English law. Whilst it does not require the claimant to prove an intention to cause loss, the claimant must prove an intention to deceive him.... A more effective alternative is that of negligence. Here the claimant faces a number of

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<sup>21</sup> *Schwenk Heinz* Cupla in Contrahendo in German, French and Louisiana Law. Tulane Law Review. 1940. V.XV.P.88.

<sup>22</sup> See *John Klein* and *Carla Bachechi*. Op. cit.

barriers. First, proving that the defendant owed him a duty of care. Secondly, that the defendant's conduct fell below the standard of a reasonable person. Thirdly, that his conduct caused a loss suffered, which was too remote a consequence of his action, and fourthly, that the loss suffered was of a type which English law is prepared to compensate."<sup>23</sup> Therefore, English law practically does not employ tort theory of pre-contractual liability and in most cases qualifies pre-contractual liability the contractual liability (arising out of a breach of the implied agreement to act fairly once negotiations have started) or provides the damaged party with the restitution remedy.<sup>24</sup>

The problems with qualification of pre-contractual liability as tort liability also arises in German law "due to its narrow view of tort law, which excludes claims for pure economic loss unless more than negligence may be shown. As a result, German law still adheres to a quasi-contractual interpretation of *culpa in contrahendo* to impose duties of good faith in the pre-contractual period."<sup>25</sup>

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<sup>23</sup> *Paula Glikier* Pre-contractual Liability in English and French Law. Kluwer Law International. 2002. P. 102.

<sup>24</sup> "The courts in Australia and England have shown much ingenuity in employing the concept of collateral contract to promote good faith by imposing – on the basis of the parties' agreement – contractual liability for breaking off negotiations prematurely.... There is no reason why a contract should not be implied from conduct in the course of negotiations, even though one party claims that negotiations were discontinued prior to the complete agreement, and even if the parties contemplated execution of a formal document which has not been signed". *Furnston M., Norisada T., Poole Jill.* Op. cit. P. 301-302.

<sup>25</sup> French law, on the contrary, "permits a broad interpretation liability, which allows the courts to compensate for detrimental reliance even if the loss was caused unintentionally. Using delict, the courts have freedom to analyze the parties' conduct without restraints of finding a contractual accord de volentes". *Paula Glikier* Op. cit. P. 125.

Contractual (or quasi-contractual) theory of pre-contractual liability rests on the assumption that in case of invalidation of the agreement its invalidity leads only to the impossibility of claiming performance of the agreement, but may still serve as a ground for claiming compensation of damages due to invalidity of the agreement. For example, von Iering was of the opinion that when parties are entering into the agreement, each of them implicitly undertakes, in addition to the main obligation under the agreement, an obligation “not to cause damages to the other party by virtue of entering into the agreement. If the agreement is found invalid in respect of its main subject matter, this special implicit obligation not to cause damages remains valid. Based on such additional implicit guarantee, the party which suffered damages as a result of invalidity of the agreement, may suit the other party for such damages.”<sup>26</sup> Thus, this theory explains only that type of pre-contractual liability that may be imposed in case of invalidity of the agreement that has already been concluded and does not add to the understanding of the nature of pre-contractual liability imposed in case of failure to enter into the agreement.

An attempt to establish an equivalent of the implicit obligation not to cause damages to the other party in the course of negotiations resulted in establishing in some modern legal systems a general “duty of fairness” (good faith duty) at the pre-contractual stage. Thus, such obligation of fair conduct (good faith duty) develops from the implicitly undertaken contractual obligation to the obligation explicitly established at the legislative level. However, the logic behind establishing the good

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<sup>26</sup> *Gaudebot Theorie Generale des Obligations*. M. 1948. P. 206-207.

faith duty at the legislative level and the logic behind the theory suggested by von Ihering is the same – there should be a duty of fairness established somewhere in order to hold a party pre-contractually liable for violation of such duty.<sup>27</sup>

Therefore, as of today, although all legal systems recognize that unfair behavior at the pre-contractual stage should lead to imposition of pre-contractual liability, there is no unity among legal systems as to the nature of such pre-contractual liability.

Despite its specifics, pre-contractual liability meets all criteria of legal liability. The ground for pre-contractual liability is causing damages to the other party to the pre-contractual process. Damages caused at the pre-contractual stage can usually be easily divided into real losses and lost profits. Real losses usually include (i) expenditures reasonably incurred in anticipation of the agreement (or in reliance on the validity of the agreement that has been concluded) and (ii) the difference between the terms on which the agreement could have been concluded (or has been concluded but thereafter invalidated) and the terms on which a substitutive agreement can be entered into.

However, if pre-contractual liability is imposed when the parties fail to enter into the agreement, it might be difficult to calculate that part of real losses that is based on the comparison of the terms of the agreement that could have been

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<sup>27</sup> Because of certain shortcomings of both the tort and contractual theory of pre-contractual liability, a new theory was developed – a theory of objective liability. The author of this theory (Windscheid) is of the opinion that pre-contractual liability should be imposed regardless of the fault or absence of fault of the party that caused damages, and such liability should be neither of contractual nor of tort nature. Pandekten II (Frankfurt, 1906). 9<sup>th</sup> ed.

concluded and the terms and conditions of the substitutive agreement, because it might be unclear on what terms the agreement would have been concluded should the negotiations not failed. The same logic applies when calculating the lost profits part of the damages. As a result, it is common that pre-contractual liability amounts only to the negative reliance interest, i.e., those expenditures that the party incurred reasonably acting in anticipation of the agreement.<sup>28</sup> “The party that claims damages cannot claim equivalent of fulfillment of the agreement, because the agreement that has never been concluded or is considered to be never concluded does not provide it with the right to claim performance. All that such party can count on is that its endeavor to enter into the invalid agreement does result in damages.”<sup>29</sup>

A mandatory condition of pre-contractual liability is the violation of established rules by one of the parties to the negotiations. Such violation can be found only in cases in which law imposes a general liability on the parties to act fairly during the contract formation stage (general good faith duty) or specifically qualifies certain types of behavior as inadmissible. Otherwise, the parties will be considered to bear their own risks of failure to enter into the agreement or invalidation of the agreement and, therefore, any damages caused by such failure or invalidity will not be subject to compensation by the other party. “A good faith duty raises two closely related questions. The first is whether if the parties agree that they will negotiate in good faith, this is an obligation to which the law will attach substance. The second is

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<sup>28</sup> *Pokrovskiy I.A.* Main Problems of Civil Law. M. 1998. P. 248.; *Ruster Bernd* Business Transactions in Germany (FGR), vol. I. P. 10-83.; BGH-decision of May 25, 1977, BGHZ 69 pp. 53 et seq.

<sup>29</sup> *Gaudemot* Op. cit. P. 205-206.

whether there are circumstances in which, even in the absence of agreement by the parties, the law should impose a duty to negotiate in good faith. English law is currently a prime example of one group which thinks that the answer to both the questions should be in the negative.... A second group, of which Australia and the United States may be members, recognizes that if the parties agree that they will negotiate in good faith, this gives rise at least in some cases to an obligation which can be enforced.... A third group goes further and imposes, at least in some circumstances, a duty to negotiate in good faith”.<sup>30</sup> Such duty to negotiate in good faith is for example included into the Italian Civil Code (§1337) and Australian Trade Law (Art. 52(1)).

German law provides another interesting example of this condition of pre-contractual liability.<sup>31</sup> Initially the general obligation to act in good faith at the pre-contractual stage existed in German law only at the level of case law. Nonetheless, even in the absence of legislative provisions, during the last century the courts always assumed that the parties should behave in good faith once they embark on contract formation procedures.<sup>32</sup> In 2002, the good faith duty as developed by courts and in legal theory found its way into the German Civil Code. As a result of the reform of obligations law, a special article was included in the German Civil Code that deals with the general duty of good faith during contract formation. As amended by the Law On Modernization of Obligations Law (that came into force on January 1, 2002),

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<sup>30</sup> *Furnston M., Norisada T., Poole Jill* Op cit. P. 271.

<sup>31</sup> *Museilak Hans-Joachim* Grundkurs BGB. München. 1999. S. 26-242.

<sup>32</sup> Reichsgericht-decision of December 7, 1911 (=RGZ 78, 239).

§311(2) of the German Civil Code establishes that “an obligation in accordance with §213(2) [an obligation to observe other party’s rights and interests] is considered to be imposed as a result of (i) commencement of negotiations, (2) preparation for entering into the agreement if one party lets the other party to affect its rights protected by law or other interests and entrusts them to such other party, or (3) other analogous business relations.” Therefore, it may be inferred that the modern German Civil Code as amended on January 1, 2002, like the Italian Civil Code, imposes on the parties a general good faith duty and, thus, adequately protects the rights and interests of the parties embarking on contract formation procedures.<sup>33</sup>

Common law legal systems and some continental law legal systems (for example, the Russian legal system) while not rejecting the need to observe a good faith duty in business relations, are still under strong influence of the venturesome theory of pre-contractual process and, thus, abstain from extending a good faith duty to the pre-contractual stage.<sup>34</sup> For example, the Restatements of Contracts (Second) of the United States (§205) and the Uniform Commercial Code of the United States (§1-203) apply the good faith duty only to performance of the agreement that has already been concluded. As the American courts opine: “the concept of a duty to carry on

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<sup>33</sup> Another example of the general duty of good faith can be found in the UNIDROIT Principles of Commercial Contracts (Art. 2.15). See also *Guillemard Sylvette* A comparative study of the UNIDROIT Principles and the Principles of European Contracts and some dispositions of the CISG applicable to the formation of international contracts from the perspective of harmonization of law. Laval University. 2 May 1999. <http://www.cisg.law.pace.edu/cisg/biblio/guillemard1.html>

<sup>34</sup> *United States v Braunstein*, 75 F. Supp. 17 (S.D.N.Y. 1947), appeal dismissed, 168 F. 2d 749 (2d Cir. 1948).

negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations.”<sup>35</sup>

However, as discussed above, even these legal systems gradually came to recognition of the need to govern parties’ relations at the pre-contractual stage. “Unlike continental law, common law strictly adhered to the freedom of contract principle and ruled that there are no mutual obligations between the parties involved in the contract formation process.... However, contemporary American doctrine welcomes the contrary view concerning pre-contractual liability. It may be inferred that during the last decades the American courts have been prepared to recognize pre-contractual liability of the parties to negotiations, in particular, in case of unjust enrichment of one of the parties, misleading the other party and making promises during negotiations.”<sup>36</sup>

Nonetheless, unlike most continental law legal systems, common law legal system and the Russian legal system do not incorporate the general good faith duty as applicable to the pre-contractual stage, but instead establish pre-contractual liability for certain specific types of unfair behavior at the pre-contractual stage. Therefore, it appears that in these legal systems a party involved in contract formation procedures is less protected from unfair actions of the other party than in continental legal systems, because it is not possible to foresee all potential types of unfair behavior to have them specifically set forth at the legislative level.

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<sup>35</sup> Walford v Miles. 1992. 2 AC 128 at 139.

<sup>36</sup> *Komarov A.S.* Op. cit. P. 51.

For example, in the Russian Federation pre-contractual liability may be imposed only in the following cases: (1) *in cases of unfair behavior by one of the parties that leads to the invalidity of the agreement* – if one of the parties were to mislead the other party, deceive the other party, exercise undue coercion, threaten the other party, maliciously plot with a representative of the other party, if the agreement was concluded due to hardness and the other party makes use of it, or the agreement was concluded by the party that could not perceive its actions and the other party make use of it; (2) *in case of the failure to enter into the agreement* – if one of the parties fails to respond to the protocol of disagreement<sup>37</sup>, if one of the parties deviates from entering into the main agreement in violation of the preliminary agreement or any other obligation to enter into the agreement, if one of the parties deviates from the state or notary registration of the agreement. Any other unfair behavior at the pre-contractual stage will not lead to imposition of pre-contractual liability (unless it qualifies as tort).

Two more mandatory conditions of pre-contractual liability (in addition to causing damages and breaching a good faith duty rule) are (i) cause-and-effect relationship between violative behavior and the damages, and (ii) fault of the defendant. It has never been very easy to establish the cause-and-effect relation, but this task becomes especially difficult when it comes to finding the cause-and-effect relation at the pre-contractual stage. Even unfair behavior may be difficult to explain and prove, not to mention the cause-and-effect relationship between such unfair

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<sup>37</sup> Applies only when entering into a supply agreement (Civil Code of the Russian Federation, Art. 507.2).

behavior and damages incurred by the other party involved in negotiations. For example, it may be problematic to prove that the position assumed by one of the parties during the negotiations was not constructive and thus lead to termination of negotiations (such as, for example, take-it-or-leave it position).

As concerns the fault of the defendant, it depends on each particular legal system whether pre-contractual liability may be imposed only for at-fault actions. For example, Russian law (Art. 401 of the Civil Code) rules that when involved in business relations the parties may be held liable even for their not-at-fault actions, unless otherwise established in law or agreement between the parties. Outside of the scope of business relations, the parties may be held liable only for their faulty actions.

5. *Some special grounds for pre-contractual liability*

Unfair behavior at the pre-contractual stage, i.e., behavior that does not comply with the trust and fairness standard established between the parties by virtue of entering into negotiations – is a very flexible concept that evades clear definition. Presumably, the duty of good faith includes at least two mandatory elements: (1) the duty to behave honestly and (2) the duty to consider the second party's interests.<sup>38</sup>

Qualification of certain actions as performed in violation of a duty of good faith will always be given by a court, which will “interpret the good faith duty by weighing colliding interests of both parties depending on their importance”.<sup>39</sup>

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<sup>38</sup> *Furntson M., Norisada T, Polle Jill* Op. cit. P. 274.

<sup>39</sup> *Pokrovskiy I.A* Op. cit. P. 116.

Practical examples of actions performed in breach of a good faith duty during negotiations are numerous and diverse, just like the ways and means to negotiate.

One example of unfair behavior at the pre-contractual stage is termination of negotiations without a due cause.<sup>40</sup> No doubt that, as a general rule, the parties should be free in deciding whether to enter into the agreement. Therefore, each party should have the right to terminate negotiations at any time. “Due cause for terminating negotiations exists when, for example, the agreement cannot be concluded due to objective circumstances or where there are already any grounds that would allow the party to rescind the agreement upon its execution.”<sup>41</sup> Such termination of the agreement is not unfair and should not lead to imposition of pre-contractual liability on the party that decided to quit further negotiations.

However, if the party breaks off negotiations in the absence of any due cause, such party should compensate damages caused to the other party that reasonably relied on execution of the agreement (especially if such reliance was invoked by the party that subsequently decided to discontinue the contract formation procedure).<sup>42</sup> Thus, for example, the UNIDROIT Principles (Art. 2.15) establish that “the violation of a duty of good faith exists when, for example, a party embarks on negotiations or continues negotiations when there is no actual will on its side to enter into the agreement.” According to one of the leading Russian civil law scholars, in such cases

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<sup>40</sup> BGH-decision of June 8, 1978, BGHZ 71 pp. 78.

<sup>41</sup> *Komarov A.S.* op. cit. P. 49.

<sup>42</sup> Judgment of March 20, 1972. Cass. Civ. Com. Fr. [1972] Bull. Iv. IV no. 93.

“the freedom of will and freedom of contract should make way to the serious interests of the commercial market.”<sup>43</sup>

In certain cases the party that terminates negotiations may use various pretexts for such termination, for example, suggesting contract terms and conditions that are obviously unacceptable. Another example of unfair behavior that may lead to termination of negotiations is when party acts in such a manner that further negotiations become altogether impossible, e.g., undertakes a ‘take-it-or-leave-it’ position.

Whether a party may terminate negotiations without the risk of being held pre-contractually liable depends on the stage of negotiations at which the party attempts to break them off.<sup>44</sup> If the parties have just started negotiating, no liability may be imposed for such termination, while if the negotiations are broken off when the agreement has already been close to execution, it is very likely that, subject to other circumstances of each case, pre-contractual liability might be imposed for such termination of negotiations.<sup>45</sup> “None of the parties may terminate negotiations without due cause, and, simultaneously, none of the parties should be forced to enter into the agreement if despite fair negotiations, the agreement cannot be concluded.”<sup>46</sup>

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<sup>43</sup> *Sinayskiy V.I.* Russian Civil Law. M. 2002. P. 312.

<sup>44</sup> “When a moment comes after which you cannot turn back depends on the circumstances of each case, especially on whether the other party had any reasonable grounds to rely on execution of the agreement and on the number of issues relating to the future agreement on which the parties have already reached understanding”. *Komarov A.S.* UNIDROIT Principles of Commercial contracts. M. 1996. P. 59.

<sup>45</sup> *Holt v. Swenson*, 252 Minn. 510, 90 N.W. 2d 724 (1958).

<sup>46</sup> *Knapp* Enforcing the Contract to Bargain. 44 N.Y.U.L. Rev. 67 (1969).

Another example of behavior that does not meet the criteria of good faith is the failure to disclose information that has substantial importance to the other party and affects contract formation (provided that such party could not obtain such information by itself and the party that deviates from disclosing information is aware of this).<sup>47</sup> For example, one party loses interest in entering into the agreement but fails to inform the other party thereof thus creating an illusion that the agreement may still be concluded.<sup>48</sup> In another court case a party that confirmed the possibility of lease extension despite the fact that it was secretly conducting negotiations about the sale of the premises, was held to compensate lessee's expenditures that the latter incurred relying on the extension of lease.<sup>49</sup>

In most cases the courts impose pre-contractual liability if the party failed to inform about change in circumstances relating to the future agreement, if such party previously informed the other party about the initial state of facts. Similarly, the party may be held liable if it failed to inform the other party about the facts on which the other party specifically inquired.<sup>50</sup> Another example of unfair silence is the failure to

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<sup>47</sup> *Chestin J., Nicholas B.* Pre-contractual Obligation to Disclose Information in Contract Law Today (Clarendon Press, 1989) ed. D. Tallon, J. Harris; *Friedrich Kessler* and *Edith Fine*. Op. cit. P. 405.

<sup>48</sup> Cass. 1. 1998. JCP 1998 II 10066 note B. Fages, Def 1998. 74 obs. D. Mazeaud. Another example: the court imposed pre-contractual liability on a party that failed to inform the other party that the house, the sale of which the parties were negotiating, had already been sold. The other party, being unaware that the house had already been sold, made a trip to have a look at the house, which turned out to be in vain. The party that failed to inform the other party about the sale of the house was held to compensate expenditures associated with such trip.

<sup>49</sup> *Markov v ABC Transfer & Storage Co.*, 76 Wash 2d 88, 457 P. 2d 535 (1969).

<sup>50</sup> *Musy A.M.* Disclosure of Information in the Pre-contractual Bargaining: a Comparative Analysis. [www.jus.it/cardozo/Review/Contracts/Musy-1995/musy1.htm](http://www.jus.it/cardozo/Review/Contracts/Musy-1995/musy1.htm)

disclose information about the circumstances that make the agreement impossible to be concluded or performed.<sup>51</sup> If one of the parties knows that certain information is important to the other party in making a decision regarding the agreement and still fails to share such information with the other party, it may also be held pre-contractually liable for unfair silence. Therefore, pre-contractual liability for unfair silence may be imposed both (i) if the agreement has not been concluded because the other party became aware of such information and of the fact that the other party concealed such information; and (ii) if the agreement was concluded but thereafter found invalid because one of the parties misled or deceived the other party during the contract formation.

Some legal systems allow imposition of pre-contractual liability for silence in response to the offer to enter into the agreement. As a general rule, silence itself cannot qualify as a proper acceptance of the offer to enter into the agreement and cannot entail any legal consequences. However, in certain cases law qualifies such silence as unfair behavior, for example, in commercial relations when the offeror, based on usages or established practices, may reasonably expect the other party to

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<sup>51</sup> A, conducting negotiations with B regarding assistance in the sale of military equipment, becomes aware that B will not be granted a license from its Government that is a condition precedent for payment for the equipment. A fails to inform B thereof and, despite such information, A enters into the agreement with B. The agreement could not be performed due to the lack of license. A should be held liable for the expenditures incurred by B after A received such information about the license. See Comments to UNIDROIT Principles of Commercial Contracts.

react to its offer (especially in cases when such other party solicited the offer).<sup>52</sup> For example, such provisions exist in American<sup>53</sup> and Russian law.<sup>54</sup>

Another example of unfair behavior at the pre-contractual stage is parallel negotiations with potential counterparties. Parallel negotiations are frequently used at the initial stage in order to make a choice between potential counterparties and to solicit a best offer. However, as the negotiations progress, a choice from among potential counterparties should be made and the other party to the negotiations may reasonably become reliant upon the exclusivity of negotiations unless it is notified that the negotiations are not exclusive.<sup>55</sup>

In certain cases lack of collaboration may also lead to imposition of pre-contractual liability (for example, when one of the parties fails to assist in filing an application necessary for the agreement to be concluded<sup>56</sup> or deviates from state registration of the agreement or registration of the agreement with a notary public.<sup>57</sup>)

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<sup>52</sup> *Friedrich Kessler and Edith Fine* Op. cit. P. 417.

<sup>53</sup> *Ammons v Wilson & Co.*, 176 Miss. 654, 170 So. 227 (1936).

<sup>54</sup> Civil Code of the Russian Federation, Art. 507.2

<sup>55</sup> The parties sometimes do not rely on the general interpretation of a good faith duty as excluding parallel negotiations and enter into special pre-contractual agreements establishing exclusivity of negotiations.

<sup>56</sup> Cour de cassation RTDC 1972. 779 and *Morin G.* Le devoir de cooperation dans les contrats internationaux: Droit et pratique. 1980. 6 DOCI 9.

<sup>57</sup> Civil Code of the Russian Federation. Art. 165.

6. *Other means of protection of parties' rights at the pre-contractual stage*

Apart from imposing pre-contractual liability, legislation in many countries provides some additional remedies to protect the rights of a party to the contract formation procedure in case of unfair behavior by the other party. In particular, most legal systems suggest three additional means of protection of parties' rights at the pre-contractual stage: (i) refusing to enforce party's rights if it abuses such rights, (ii) imposing an obligation to compensate unjust enrichment and (iii) imposing public-law liability on a party that behaved unfairly and thus violated competition and antitrust legislation.

Freedom of contract principle commands that a party may terminate negotiations at any time or conduct negotiations in any manner it wishes. However, in certain cases exercising of such right to terminate negotiations at any time and to conduct negotiations in any manner may result in damages to the other party. If the legislation does not provide for a general good faith duty, such damages may appear to be unrecoverable. In other words, when establishing a general duty of good faith, the law sets forth new boundaries of law, the trespassing of which leads to imposition of pre-contractual liability. If the law does not establish such general duty of good faith, the same behavior (e.g., termination of negotiations without due cause) does not qualify as trespassing the boundaries established by law and thus cannot lead to imposition of pre-contractual liability. This is when the provisions on abuse of rights come into play and help to protect the other party's rights. For example, if the damaged party claims compensation of damages and the other party refuses to compensate such damages claiming that it has acted on the basis of freedom of

contract and exercised its right to terminate negotiations or conduct negotiations in any manner it wishes, the court may reject such arguments thus refusing to enforce the right that belongs to such party.<sup>58</sup> Therefore, boundaries, the trespassing of which may lead to rejection in enforcement of rights, are established in each particular case by the court,<sup>59</sup> rather than by the legislator. This is why the abuse of rights concept is sometimes criticized<sup>60</sup> and why some legal systems still do not recognize the abuse of rights concept unless the only purpose of such abuse was to cause damages to the other party (*shikana*) (because in case of *shikana* there are clear guidelines for the court as to what behavior should qualify as the abuse of rights). And even if the abuse of rights concept is recognized, there is still uncertainty as to what criteria the court should apply to make a conclusion that a person abused his rights: whether it should be some “social function of rights” or “legal aim of rights” or any other “super-individual” function of rights. In any case, any such criteria should be defined as flexibly as possible so that the abuse of rights concept can accommodate the demands of the changing market. This flexibility and intangibility of such criteria lead to the impossibility of establishing them in law.<sup>61</sup> “By allowing the courts to establish

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<sup>58</sup> *Josserand L. Droit civil positif francais. Sirey. 193. 2<sup>nd</sup> ed. II. No. 436; Durry Law distinction de la responsabilite contractuelle et de law responsabilite delictuelle. Montreal. 1986. No. 92; Braginskiy M.I. and Vitrianskiy V.V. Contract Law. General Provisions. M. 1997.*

<sup>59</sup> *Agarkov M.M. Problems of abuse of rights in Soviet civil law// Some works on civil law. M. 2002. P. 370.*

<sup>60</sup> See, e.g., *Pokrovskiy I.A. Op. cit.;* abuse of rights concept was not recognized by Roman law.

<sup>61</sup> *Pashin V.M. The Concept of Abuse of Subjective Rights de lege ferenda// Urgent problems of civil law. Vol. 7 M. 200. P. 28-31.*

where there was abuse of rights, by allowing them to weigh the colliding interests of the parties...we actually welcome application of criteria that are not established in law”.<sup>62</sup>

Although the criteria for the abuse of rights are difficult to establish, it is clear that it is the good faith concept that always stands behind any such criteria, i.e., the same good faith concept that is used by those legal systems that made their choice in favor of establishing a duty of good faith as applicable to the pre-contractual stage (thus establishing new boundaries of law). However, the good faith principle that applies to make a conclusion as to whether there was an abuse of rights differs from the good faith principle as a mandatory obligation imposed on the negotiating parties. “The good faith principle means honesty in people’s relations. It means that each person should justify trust between people without which no commercial transactions are possible. However, the issue of exercising rights falls outside this good faith criteria. The question of trust arises when it is needed to establish the meaning of will, interpret or fill up a gap in a contract. The good faith principle means the struggle against direct or indirect deceit or making use of having somebody mislead. This is not what is important in case of the abuse of rights, because in this case the good faith principle leads to establishing new boundaries of rights.”<sup>63</sup>

In addition to this difference, there is also a difference in available remedies. In case the good faith principle is established as a mandatory rule to which the negotiating parties should adhere, a party who failed to observe this principle should

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<sup>62</sup> *Pokrovskiy I.A.* Op. cit. P. 116.

<sup>63</sup> *Agarkov M.M.* Op. cit. P. 376.

compensate the damages caused by its unfair behavior to the other party. While in case of abuse of rights, the only remedy that is available is the refusal to enforce the right that has been abused. In other words, the party that suffered damages as a result of an abuse of rights cannot claim compensation of such damages (unless such abuse qualifies as tort).<sup>64</sup>

Further, the abuse of rights theory can be used only in a limited number of cases and does not cover all possible types of unfair behavior at the pre-contractual stage. For example, it may apply when one of the parties terminates negotiations or refuses to enter into the agreement, but it is useless when the agreement has been concluded but was thereafter invalidated due to the unfair behavior of one of the parties at the pre-contractual stage. In order to protect the parties' rights in the latter case, law should establish a general duty of good faith (as, for example, Italian law does) or should set forth pre-contractual liability for this particular type of unfair behavior (as, for example, Russian law does). Therefore, the abuse of rights theory can serve only as an additional but not the only or the primary tool for protecting the parties' rights at the pre-contractual stage.

Another special tool for protecting the parties' rights at the pre-contractual stage is the concept of unjust enrichment (restitution). The obligation to return the unjust enrichment is not pre-contractual liability. However, it may also be applied by a party that has suffered damages caused by the unfair behavior of the other party during the contract formation. The unjust enrichment concept may apply if the party

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<sup>64</sup> Civil Code of the Russian Federation, Art. 10. In certain cases abuse of rights may qualify as a tort, e.g., when the only aim of the abuse of right was to cause damages on the other party's side (*shikana*).

that behaved unfairly gained benefits at the expense of the other party as a result of such unfair behavior.

In most cases the unjust enrichment concept comes into play when one of the parties discloses to the other party certain information in the course of negotiations and such other party continues to use this information upon termination of unsuccessful negotiations. In this case the information is received legally (i.e., it was disclosed by the owner of such information at its own will), therefore the provisions that apply in case of unlawful gathering of confidential information do not apply. If the parties plan to disclose certain confidential information during the negotiations, they sometimes enter into confidentiality agreements that would establish the terms and conditions of the disclosure and use of such information. If such agreement has not been concluded and one of the parties still uses the confidential information it received in the course of negotiations, it may be obliged to return the unjust enrichment it got as a result of the use of such information. For example, the UNIDROIT Principles place an obligation on the parties to keep the information they receive during the negotiations confidential and abstain from using such information upon termination of negotiations regardless of whether the agreement was concluded or not. “In appropriate cases the remedies that may be available include compensation based on the benefits received by one party at the expense of the other.”

There is no concordance between various legal systems and scholars as to the nature of this obligation to return benefits received as a result of the use of confidential information. Thus, some scholars suggest considering that the parties be bound by the implied contract not to use the confidential information. The others are

of the opinion that the use of confidential information upon termination of negotiations should qualify as tort. And, finally, there is a third group of scholars who insist that it is the unjust enrichment concept that should apply in this case. It goes without saying, that the amount of compensation available to the damaged party will depend on which of the above ways of protecting its rights applies.<sup>65</sup>

Another example of when the unjust enrichment concept may help to protect the parties' rights during the contract formation procedure, is recovery of damages caused as a result of termination of the negotiations after one party has begun performance of a yet-to-be-concluded agreement at the request of the other party. "When both parties had confidently expected a formal contract to eventuate and, to expedite performance, one party had been requested to commence the contract work, the law would impose an obligation on the party who made the request to pay a reasonable sum for that work. Such an obligation arose "in quasi-contract" or as we now say, in restitution."<sup>66</sup> If there was no special request on the side of one of the parties to commence performance, courts in most cases will decide that the party that commenced performance of the yet-to-be-concluded agreement acted at its own risk and thus cannot claim compensation of damages incurred as a result of such performance of the agreement that has not been concluded (if there are no other grounds for holding the other party pre-contractually liable).<sup>67</sup>

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<sup>65</sup> *Allan Farnsworth. Op. Cit.*

<sup>66</sup> *Paula Glier Op. cit. P. 84.*

<sup>67</sup> *Regelian Properties plc. V London Docklands Development Corp. 1995. 1 WRL 212.*

However, when applying a concept of unjust enrichment, one should be aware of some problems that inevitably arise when the unjust enrichment concept is applied for recovery of damages caused at the pre-contractual stage. The first problem is connected with possible unjust overcompensation of one party (who performed work at the request of the other party) at the expense of the other party if such work has not been completed. This becomes possible “if the court fails to take account of deficiencies in the claimant’s performance which diminish its value to the defendant.... This throws the whole risk of negotiations breaking down after performance on the defendant who has to pay for everything he actually receives but gets no protection in relation to any expectations he had of greater or better performance...[because] restitutionary remedy imposes no obligation on a party to continue work commenced.”<sup>68</sup>

The second problem that may arise is associated with the difficulties in establishing whether there actually was any unjust enrichment and calculating the amount of such unjust enrichment. “There are obvious difficulties in proving that a defendant has benefited from preparatory work for a project with which the defendant decided not to proceed. A half-completed building is unlikely to benefit a party who has decided to sell the site or to construct a different building. In reality, such a party is more likely to incur further costs in clearing the site...”<sup>69</sup> On the face of it, these difficulties with calculating and proving unjust enrichment may help to resolve the

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<sup>68</sup> *Paula Glikier* Op. cit. P. 85. *SN Balli* Work carried out in pursuance of intent – contract or restitution? 198. 99 LQR 572, 577.

<sup>69</sup> *Paula Glikier* Op. cit. P. 87.

above-discussed problem with potential overcompensation for defective and incomplete work. However, the problem is more difficult than it may appear to be prima facie. Thus, some scholars and practitioners are of the opinion that “where a defendant has chosen to accept the claimant’s performance in the full knowledge that this performance was not intended to be gratuitous, this is a sufficient indicator that a benefit has been received.”<sup>70</sup>

And thirdly, imposing an obligation to return unjust enrichment without paying attention to the reasons for breaking off negotiations may also lead to unfair results.

Therefore, the provisions on unjust enrichment may serve only as an additional but not the only or principal way of protecting the parties’ rights in contract formation and it may apply only when the circumstances of each particular case prove that the parties renounced the general rule that each party bears its own risks associated with contract formation.

In addition to remedies suggested by private law, public law may also provide the parties with certain protections against unfair behavior at the pre-contractual stage. For example, antitrust and competition legislation of most countries includes provisions on abuse of dominant or monopolistic position in the market (e.g., when a company that is a monopolist in a certain market refuses to enter into the agreement although it has the ability to do so or when such a company, making use of its monopolistic position in the market, imposes certain terms and conditions of the

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<sup>70</sup> Ibid.

agreement on the other party).<sup>71</sup> In certain cases unfair behavior of one of the parties to the negotiations may qualify as unfair competition that is prohibited by antitrust law (e.g., dissemination of false or inaccurate information about a competitor, about the products and goods, etc.).<sup>72</sup>

If one of the parties to the contract formation procedure violates the antitrust legislation that governs contract formation, antitrust legislation imposes liability on such a party regardless of whether any private-law remedies are available to the damaged party. The difference between the private-law remedies and the public-law remedies is significant. Private-law remedies are designed to provide the damaged party with relief by imposing the obligation on the other party to compensate damages caused by its unfair behavior. While public law holds the party that acted unfairly in violation of antitrust legislation liable towards the state and entire community, rather than towards the other party to the negotiations that actually suffered from such unfair behavior. Thus, competent government bodies may impose fines payable to the state budget or issue mandatory directives prohibiting certain actions or ruling to perform certain actions to recover violation of antitrust legislation. Sometimes competent government bodies are also authorized to file suits in court claiming invalidation of transactions concluded in violation of antitrust legislation. However, even if imposition of public-law liability entails certain private-law results (for example when

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<sup>71</sup> See, e.g., Art. 5 of the Federal Law on the Russian Federation On Competition and Restriction of Monopolistic Activities in Commodities Markets No. 948-1 of March 22, 1991.

<sup>72</sup> See, e.g., Art. 10 of the Federal Law on the Russian Federation On Competition and Restriction of Monopolistic Activities in Commodities Markets No. 948-1 of March 22, 1991.

the agreement is invalidated at the claim raised by the government bodies), such liability is imposed at the initiative of government bodies rather than the party that suffered from the unfair behavior. In addition, public-law remedies are available only in a limited number of cases, i.e., when the parties' behavior violates the rules established in antitrust and competition legislation (mostly in cases of misuse of a dominant or monopolistic position in the market and unfair competition) and thus do not embrace all possible types of unfair behavior in contract formation.

Therefore, public-law remedies may serve only as additional protection of parties' rights at the pre-contractual stage supplementing but not superseding the remedies provided by private-law (such as imposition of pre-contractual liability, application of unjust enrichment or abuse of rights provisions).

## CONCLUSION:

Today preference is often given to negotiations over the classic procedure for contract formation. Many issues which arise during this new procedure for contract formation through negotiations need special regulation (e.g., unfair negotiations, the right to exit negotiations, exclusivity of negotiations, the terms of the executed contract in the absence of a single document, etc.). Developing the rules regulating this procedure for contract formation becomes a challenging assignment for all legal traditions.

Initially all legal systems adhered to the venturesome (aliatory) theory of negotiations placing all pre-contractual risks on each party and did not allow recovery of any damages incurred in the course of contract formation unless and until the parties undertook contractual obligations or committed tort. However, with the passage of time, the venturesome theory proves to be inflexible and unable to accommodate market demands, its application having sometimes drastic and unfair consequences. As a result, most legal systems came to recognize the need to govern the parties' relations at the contract formation stage. Due to the diversity of contract negotiations techniques and methods, as well as the ways of putting together the understandings reached in the course of negotiations, such techniques, methods and ways cannot be so easily unified and formalized as the classic contract formation procedure. Therefore, most legal systems, instead of working out detailed provisions that would govern this new contract formation procedure, decided in favor of establishing only general principles of pre-contractual behavior and imposing pre-contractual liability for failure to observe such principles.

At present, all legal systems recognize that the ground for imposition of pre-contractual liability is unfair behavior, or breach of the good faith duty, at the pre-

contractual stage. However, legal systems differ in how they establish this good faith duty. Some legal systems impose general obligation of good faith on the parties embarking on contract formation, while other legal systems impose pre-contractual liability only for certain types of unfair behavior at the pre-contractual stage and abstain from imposing a general obligation of good faith. However, regardless of the way in which pre-contractual liability is incorporated, all legal systems recognize two types of pre-contractual liability: (i) liability that is imposed when parties fail to enter into an agreement due to unfair behavior of one of the parties at the pre-contractual stage, and (ii) liability that is imposed when an agreement has been concluded but was thereafter invalidated due to unfair behavior of one of the parties at the pre-contractual stage.

Although there is no agreement between various legal systems as to the qualification of pre-contractual liability, all legal systems are uniform in that the term “pre-contractual” as applied to liability does not mean that pre-contractual liability is a type of liability separate from contractual (or quasi-contractual) or tort (or quasi-tort) liability. The term “pre-contractual” only indicates the stage at which a party acted improperly that lead to imposition of liability. Unjust enrichment, abuse of rights and antitrust and competition law provide for some additional remedies to protect the parties’ rights at the pre-contractual stage, that may apply in addition but cannot supersede remedies available to the parties as a result of imposition of pre-contractual liability.