

## Case Note

### I. Introduction

In this decision<sup>1</sup> the European Court of Justice (ECJ) deals with the problem of the characterisation of pre-contractual liability for unjustified withdrawal from negotiations, for the purpose of applying the Brussels Convention.<sup>2</sup> Should pre-contractual liability of this kind be characterised as contractual, the jurisdiction would be determined under art 5 (1) of the Convention. On the other hand, should it be characterised as non-contractual, the jurisdiction would be determined under art 5 (3).<sup>3</sup>

This decision is technically of primary interest to the private international lawyer, since it only deals with the characterisation of pre-contractual liability for the purpose of determining the international jurisdiction. It is well known that, in order to apply art 5 (1) and (3) of the Convention, the characterisation as contractual or non-contractual is autonomous and therefore has to be made with no reference to national laws, but rather with exclusive reference to the goals of the Brussels Convention.<sup>4</sup> This principle has been restated by the Court in this decision.<sup>5</sup> Technically then it could be argued that the outcome of the present case has no value outside the borders of the Convention, as far as single national laws are concerned or as far as the

- 1 Case 334/00 *Tacconi* [2002] ECR I-7357 (ECJ). On this decision see also: M. J. Bonell, 'Responsabilità precontrattuale, Convenzione di Bruxelles sulla competenza giurisdizionale e l'esecuzione delle sentenze e ... principi UNIDROIT' (2003) XVII *Diritto del commercio internazionale* 183; A. Huet, (2003) CXXX *Journal du droit international* 668; M. Requejo Isidro, (2002) LIV *Revista española de derecho internacional* 877; P. Mankowski, 'Die Qualifikation der *culpa in contrahendo* – Nagelprobe für den Vertragsbegriff des europäischen IZPR und IPR' (2003) XXIII *Praxis des internationalen Privat- und Verfahrensrechts* 127; P. Franzina, 'La responsabilità precontrattuale nello spazio giuridico europeo' (2003) LXXXVI *Rivista di diritto internazionale* 714; P. Bertoli, 'Criteri di giurisdizione e legge applicabile in tema di responsabilità precontrattuale alla luce della sentenza Fonderie Meccaniche Tacconi' (2003) IXL *Rivista di diritto internazionale privato e processuale* 109.
- 2 Brussels Convention of 27 September 1968 (a consolidated version of the Brussels Convention was published in OJ EC C 27 of 26 January 1998).
- 3 Art 5 of the Brussels Convention has now been replaced between Member States by art 5 of the Council Regulation (EC) n 44/2001 (OJ EC L 12 of 16 January 2001).
- 4 Case 34/82 *Martin Peters Bauunternehmung* [1983] ECR 987 (ECJ), paragraphs 9 and 10; Case C-261/90 *Reichert and Kockler* [1992] ECR I-2149, paragraph 15; Case C-26/91 *Handte* [1992] ECR I-3967, paragraph 10; all cited by the ECJ in the present decision.
- 5 Paragraph 19.

formation of a body of European contract and tort rules is concerned.<sup>6</sup> However, it is also clear that this decision's effects are capable of spilling over to national laws, especially to those laws where the issue of the characterisation of pre-contractual liability for internal purposes (length of prescription, measure of damages, proof of culpability) is still unsettled.<sup>7</sup>

- 6 Pre-contractual duties have recently gained great attention from scholars interested on the building of common European principles. It should be recalled that the Principles of European Contract Law (PECL) accepted the duty to negotiate in good faith, see art 2:301 PECL (Negotiations Contrary to Good Faith) and also art 1:201 (Good Faith and Fair Dealing). Comments to these articles can be found in Lando and Beale (eds), *Principles of European Contract Law Part I and II* (The Hague: Kluwer Law International, 2000). On the side of the pre-contractual duties to inform see R. Schulze / M. Ebers / H. C. Grigoleit (eds), *Informationspflichten und Vertragsschluss im Acquis communautaire* (Tübingen: Mohr-Siebeck, 2003) and V. Roppo, 'Formation of Contract and Precontractual Information from an Italian and Romance Perspective (With some Final Remarks from the Perspective of European Contract Law)', paper presented at the SECOLA conference in Vienna 18–19 June 2004, forthcoming. Generally on good faith in European contract law see R. Zimmermann and S. Whittaker (eds), *Good Faith in European Contract Law* (Cambridge: Cambridge University Press, 2000).
- 7 This is the case of Italian law. The extra-contractual characterisation is supported by V. Roppo, 'Il contratto', in G. Iudica and P. Zatti (eds), *Trattato di diritto privato* (Milano: Giuffrè editore, 2001) 184–186; R. Sacco and G. De Nova, 'Il contratto', in R. Sacco (ed), *Trattato di diritto civile* (Torino: UTET, 2004) 3<sup>rd</sup> ed, vol II, 260–261; C. M. Bianca, 'Il contratto', in C. M. Bianca (ed), *Diritto civile* (Milano: Giuffrè editore, 2000) 2<sup>nd</sup> ed, 157–162. The contractual characterisation is supported by F. Galgano, *Diritto civile e commerciale* (Padova: Cedam, 2004) vol II-1, 635; F. Benatti, *La responsabilità precontrattuale* (Milano: Giuffrè editore, 1963) 126–132; L. Mengoni, 'Sulla natura della responsabilità precontrattuale' (1956) LIV *Rivista di diritto commerciale* part II, 360. However, it should be noted that the *Corte di Cassazione* is consistently taking the extra-contractual view. Most recently see Cass, sez un, 16 July 2001, n° 9645 in (2002) CXXVII *Foro italiano* I, 806. In French law the extra-contractual characterisation prevails. J. Ghestin, 'Le contrat: formation', in J. Ghestin (ed), *Traité de droit civil* (Paris: Librairie Générale de Droit et de Jurisprudence, 1988) 2<sup>nd</sup> ed, 250–253; G. Viney, 'Introduction à la responsabilité', in Ghestin (ed) above (1995), 2<sup>nd</sup> ed, 356–357; J. Schmidt, 'La sanction de la faute précontractuelle' (1974) LXXIII *Revue trimestrielle de droit civil* 46, 50–53. In Germany, at the opposite, the contractual characterisation prevails. K. Larenz, *Lehrbuch des Schuldrechts: Allgemeiner Teil* (Munich: Verlag C. H. Beck, 1987) 14<sup>th</sup> ed, 105. The contractual characterisation has been recently adopted by the German legislator in the new version of § 311 Abs 2 BGB. K. Larenz and M. Wolf, *Allgemeiner Teil des bürgerlichen Rechts* (Munich: Verlag C. H. Beck, 2004) 9<sup>th</sup> ed, 592–594.

## II. Facts

In the case at hand, an Italian firm sued a German firm for harm suffered because of its unjustified withdrawal from negotiations for the sale of some machinery. The case is complicated by the fact that the machinery should have been bought by a financial company, which would have then leased it to the plaintiff. We will leave this complication aside. The Italian firm was interested in characterising this kind of liability as extra-contractual. The German firm had the opposite interest and therefore argued in favour of the contractual characterisation.<sup>8</sup>

## III. Decision of the Court

The ECJ argues that application of art 5 (1) requires the existence of an obligation freely assumed by one party towards the other.<sup>9</sup> Pre-contractual liability, in its view, is not based on a freely assumed obligation, but rather on the law itself.<sup>10</sup> Therefore, the ECJ rules that pre-contractual liability for breaking off negotiations is to be qualified as non-contractual.

## IV. Precedents

The ECJ already had many occasions to clarify its view on the issue of what is a contract and what is not a contract (tort, delict, or quasi-delict) under art 5 of the Brussels Convention.<sup>11</sup> However, this is the first decision of the ECJ on the specific issue of the characterisation under art 5 of the Convention of pre-contractual liability for unjustified withdrawal from negotiations.

## V. The contractual characterisation of pre-contractual liability and its critics

In its first appearances pre-contractual liability for breaking off negotiations was generally given contractual nature. This characterisation was based on the idea of the existence of an implicit or tacit contract between the parties to compensate each other for any harm unjustly caused during negotiations.<sup>12</sup>

<sup>8</sup> For a more detailed exposition of the facts and the procedure of the case please refer to the decision itself and to the opinion of the General advocate.

<sup>9</sup> *Handte*, n 4 above, paragraph 15; Case C-51/97 *Réunion Européenne and Others* [1998] ECR I-6511 (ECJ), paragraph 17.

<sup>10</sup> Paragraphs 25–26.

<sup>11</sup> See decisions cited at n 4 and 9 above.

<sup>12</sup> G. Faggella, 'Dei periodi precontrattuali e della loro vera ed esatta costruzione scientifica', in *Scritti giuridici in onore di C. Fadda* (Napoli: Luigi Pierro Editore, 1906) vol

Later, the idea of an implicit or tacit contract was criticized by legal scholars on the ground that it was a misleading and normally useless fiction. This fiction was of some use only within national laws where there was some kind of limitation on the ability of the judiciary to create new kinds of extra-contractual liability, such as in Roman and German laws. On the other hand, it was of no use in all other national laws where such limitations did not exist.<sup>13</sup> This was – and still is – the case, for example, in French and Italian laws. In such laws it would have been more coherent from a systematic point of view to characterise liability arising out of negotiations as extra-contractual. After all, how could there be contractual liability without a contract?

Because of the apparent soundness of these criticisms, the extra-contractual characterisation soon gained predominance across different countries, with the notable exception of Germany, where there are in fact limitations to the extra-contractual characterisation. It is well known that German law does not generally compensate pure economic losses, such as the losses normally suffered because of failed negotiations.<sup>14</sup>

However, it should be considered that the term ‘contractual’ in this context is currently used as a short hand way of expressing the idea that the duty to bargain in good faith and the duty not to withdraw from negotiations without justification are not general duties owed to the public at large, but rather they are obligations.<sup>15</sup> With the use of the term ‘obligation’, it is meant there is a duty that a party to a special legal relation owes to her counter-party and to no one else.<sup>16</sup> In other words, the breach of a pre-contractual duty should be treated as a breach of contract, rather than a breach of the general duty not to harm third parties without justification (*alterum non laedere*).

III, 268, 297–304; R. Saleilles, ‘De la responsabilité précontractuelle: a propos d’une étude nouvelle sur la matière’ (1907) VI *Revue trimestrielle de droit civil* 697, 718–721. On the theories of these early authors see A. T. von Mehren, ‘The Formations of Contracts’, in A. T. von Mehren (ed), *Contracts in General*, in *International Encyclopedia of Comparative Law* (Tübingen: Mohr-Siebeck, 1992) vol VII, ch 9, 64–66. Sharing the contractual approach: M. Planiol, G. Ripert and P. Esmein, *Traité pratique de droit civil français* (Paris: Librairie Générale de Droit et de Jurisprudence, 1954) 151–152.

13 H. Mazeaud, L. Mazeaud and A. Tunc, *Traité théorique et pratique de la responsabilité civile* (Paris: Editions Montchrestien, 1965) 6<sup>th</sup> ed, vol I, 150–151; Ghestin, n 7 above, 250–251.

14 § 823 Abs 1 BGB. Larenz, n 7 above, 105. M. Bassani and V.V. Palmer, ‘The liability regimes of Europe – their façades and interiors’, in M. Bassani and V.V. Palmer (eds), *Pure Economic Loss in Europe* (Cambridge: University Press, 2003) 148–151.

15 Mengoni, n 7 above, 360; Galgano, n 7 above, 635. U. Breccia, ‘Le obbligazioni’, in Iudica and Zatti, n 7 above, 8–9.

16 Larenz, n 7 above, 6–7; J. Carbonnier, *Droit Civil: les obligations* (Paris: Presses Universitaires de France, 2000) 22<sup>nd</sup> ed, vol IV, 28.

From a systematic point of view, the contractual characterisation of this kind of liability is justified by the fact that an obligation does not need a contract to exist, but rather can be based directly on the law, should this be appropriate.<sup>17</sup> In the context of negotiations leading to a future contract, the obligation to bargain in good faith is grounded on the existence of a 'transactional' or 'social' contact between the negotiating parties.<sup>18</sup>

On the whole, the impression is that the issue of the characterisation of pre-contractual liability cannot be solved on the basis of a systematic approach, but rather requires an appreciation of the practical consequences of the two possible outcomes.<sup>19</sup>

## VI. The practical relevance on the ground of national laws of the characterisation of pre-contractual liability

The characterisation of some kinds of liability as contractual or as extra-contractual may have different consequences depending on the national law under consideration. Under Italian law, for example, contractual and extra-contractual liabilities are treated differently in respect of the measure of damages, the length of prescription, and the burden of proof of fault. Regarding the measure of damages, the limitation of compensation to foreseeable losses applies to contractual liability, but does not apply to extra-contractual liability.<sup>20</sup> With respect to the length of prescription, claims based on contracts expire after a longer period (generally 10 years) than claims based on tort (generally 5 years).<sup>21</sup> Finally, regarding the burden of proof of fault, in

17 See Larenz, n 7 above, 2–4, 106; C. Castronovo, *La nuova responsabilità civile* (Milano: Giuffrè editore, 1997) 2<sup>nd</sup> ed, 193.

18 Larenz, n 7 above, 14. Such obligations are known in the German literature as *Schuldverhältnis ohne Leistungspflicht*. Ibid, 14. They are similarly known in Italian law as *obbligazione senza prestazione*. Castronovo, n 17 above, 181–182. A recent decision of the *Corte di Cassazione* on medical malpractice – qualifying the doctor's liability as contractual irrespective of the fact that there was no contract between the doctor and the patient – was recently grounded on the existence of such obligations. Cass, sez III, 22 January 1999, n° 589 in (1999) CXXIV *Foro italiano* I, 3332.

19 See A. von Mehren, 'A general view of contract', in von Mehren (ed), n 12 above, ch 1 (1982), 5. A European perspective on this issue can be found in C. von Bar, *The Common European Law of Tort* (Oxford: Clarendon Press, 1998) I, 492–497.

20 Art 1225 *codice civile*. C.M. Bianca, 'La responsabilità', in Bianca (ed), n 7 above, 153–154. This rule is well known in its common law version. *Hadley v Baxendale*, 9 Ex 341, 156 Eng Rep 145 (1854). For a comparative account see G.H. Treitel, *Remedies for breach of contract* (Oxford: Clarendon Press, 1988) 150–162.

21 Art 2946 and 2947, § 1, *codice civile*, respectively. F. Roselli and P. Vitucci, 'La prescri-

contracts generally the debtor – ie the defendant – has to prove that breach was not due to his fault, whereas in extra-contractual liability generally the victim – ie the plaintiff – has to prove that harm was due to the injurer's fault.<sup>22</sup>

The application to pre-contractual liability of the rule limiting damages to what was foreseeable requires some additional comment. This rule should not apply to losses consisting of expenses uselessly incurred during negotiations. Such damages are typically limited by reference to the principle of what was reasonable to invest in negotiations.<sup>23</sup> Investing an unreasonable amount of resources, in the light of the value of future performance and the probability of concluding the contract, would amount to fault on the part of the victim.<sup>24</sup> On the other hand, the rule of foreseeability could apply to damages consisting in lost opportunities. The party that suffered harm because of her counter-party's late withdrawal from negotiations could prove that she would have made the deal with a third party, if it were not for these failed negotiations. In such cases, the rule limiting compensation of damages to what was foreseeable at the time of negotiations could apply. Moreover, this rule could also apply to those liability cases, often qualified as pre-contractual, where it is not clear whether reliance or expectation damages should be compensated, as for example, in misrepresentation cases.<sup>25</sup>

## VII. The role of transaction costs with respect to liability rules generally

From an economic point of view, the differences between these two sets of rules are justified by the fact that activities ruled by contractual liability are normally characterized by low transaction costs, whereas activities ruled by

zione e la decadenza', in P. Rescigno (ed), *Trattato di diritto privato* (Torino: UTET, 1998) 2<sup>nd</sup> ed, vol XX, 554–591.

22 Art 1218 and 2043 *codice civile*. Bianca, n 20 above, 581.

23 P. Gallo, 'La responsabilità precontrattuale: il quantum' (2004) *L. Rivista di diritto civile* II, 487, 504, 511–515.

24 See generally Treitel, n 20 above, 188–192.

25 In English law reliance damages are usually compensated. S.J. Whittaker, in H. Beale (ed), *Chitty on contracts* (London: Sweet & Maxwell, 2004) 29<sup>th</sup> ed, vol I, 69–70; H. Beale, *ibid*, 455–457; G.H. Treitel, *The law of contract* (London: Sweet & Maxwell, 1999) 10<sup>th</sup> ed, 332–334. In American law, on the other hand, expectation damages ('loss from bargain'), rather than reliance damages ('out of pocket'), are more frequently compensated. W. Prosser, W.P. Keeton, D.B. Dobbs, R.E. Keeton and D.G. Owen (eds), *Prosser and Keeton on the Law of Torts* (St. Paul, MN: West Group, 1984) 5<sup>th</sup> ed, 765–770. But see H. Kötz, *European contract law* (Oxford: University Press, 1997) vol I, 208 stating that 'everyone agrees that in all these cases the appropriate quantum of recovery is the "reliance interest"'.

extra-contractual liability are normally characterized by high transaction costs. The level of transaction costs affects the ability of the parties to exchange information and to allocate risks between them.<sup>26</sup>

Very instructive in this respect is the rule limiting recoverable damages to what was foreseeable by the breaching party at the time she entered into the contract. This rule provides an incentive to a creditor, who has an extraordinary high interest in performance, to reveal this information to the debtor (the party that is promising performance). By revealing this information, the creditor will recover in the case of breach the full value of performance. On the contrary, by not revealing this information, the creditor will recover in the case of breach only a fraction of this value, ie what was foreseeable by his counter-party. This rule enables the debtor to fully evaluate the risk he is assuming by entering into the contract (which is equal to the value of performance to the creditor multiplied by the probability of not performing). Therefore, should the creditor reveal that he has an extraordinary high interest in performance, the debtor could ask a greater price to compensate for the risk he is assuming by promising to perform, or refuse to enter a contract altogether.<sup>27</sup>

The rule limiting recoverable damages to what was foreseeable at the time of action is only practicable in contexts where transaction costs are sufficiently low that parties can exchange information, such as in contractual relations. The same rule could not work to the same ends in contexts where transaction costs are sufficiently high to prevent exchange of information, such as in extra-contractual relations, where harm typically arises between strangers.

The different levels of transaction costs can also be argued to play a role with respect to the different lengths of expiration terms under the statute of limitations for claims based on torts and claims based on contract, as is the case in Italian law. Where transaction costs are low, parties can exchange documents: therefore writings are available for future claims. Where transaction costs are high, parties cannot exchange documents: therefore only testimonies are available. Writings are more trustworthy than testimonies. Moreover, their greater trustworthiness with respect to testimonies increases with time, because witnesses tend to forget or to change their views on the same facts,

<sup>26</sup> See Mankowski, n 1 above, 131.

<sup>27</sup> I. Ayres and R. Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) *IC The Yale Law Journal* 87, 101-104; L. A. Bebbchuk and S. Shavell, 'Information and the scope of liability for breach of contract: the rule of *Hadley v. Baxendale*' (1991) *VII Journal of Law, Economics, and Organization* 284.

while written documents remain the same.<sup>28</sup> It seems reasonable then to allow claims normally based on written contracts for a longer period than claims normally based on witness statements (torts or delicts).<sup>29</sup>

### VIII. The role of transaction costs with respect to pre-contractual liability

Negotiations are normally characterized by low transaction costs. This idea is intuitively present in the view shared by German legal scholars according to whom between negotiating parties there is a so-called *geschäftlicher Kontakt* (a 'transactional' contact).<sup>30</sup> This contact should be viewed as operating *ex ante* and as enabling parties, before any harm occurs, to exchange information and to allocate risks, specifically those relating to the negotiations and their outcome, in the same manner as the parties share information with respect to risks relating to future performance in the contract. Because of these analogies, it can be argued that, in order to regulate the parties' conduct during negotiations, the set of rules labeled as contractual liability should be regarded as more appropriate than the set of rules labeled as extra-contractual liability.<sup>31</sup>

28 See A. Iannaccone, 'Art. 2947: Prescrizione del diritto al risarcimento del danno', in P. Vitucci (ed), vol II, *La prescrizione*, in P. Schlesinger and A. D. Busnelli (eds), *Il codice civile: Commentario* (Milano: Giuffr  editore, 1999) 137–138; Roselli and Vitucci, n 21 above, 559.

29 Such a differentiated system has been adopted also in France, where claims based on contracts expire after 30 years, while claims based on delicts expire after 10 years. See M. Bruschi, *La prescription en droit de la responsabilit  civile* (Paris: Economica, 1997) 37–38. This differentiation has been criticised by F. Chabas, 'Commentaire de la loi du 5 juillet 1985, "tendant   l'am lioration de la situation des victimes d'accidents de la circulation et   l'acc l ration des proc dures d'indemnisation"' (1985) LIX *La Semaine Juridique* I, 3205, n  24. Germany originally adopted a differentiated system. For a critical survey of the older system see R. Zimmermann, 'Extinctive Prescription in German Law', in E. Jayme (ed) *German National Reports in Civil Law Matters for the XIVth Congress of Comparative Law in Athens 1994* (Heidelberg: C. F. M ller Verlag, 1994) 153. For the present system see K. Larenz / M. Wolf, n 7 above, 301–302. Moreover, it is noteworthy that the differentiated system was rejected by the PECL in favour of a three years general period of prescription for all claims covered, contractual and extra-contractual, Art. 14: 201. See the comment to this article in O. Lando / E. Clive / A. Pr n / R. Zimmermann (eds), *Principles of European Contract Law Part III* (The Hague: Kluwer Law International, 2003) 162–166. See also R. Zimmermann, *Comparative Foundations of a European Law of Set-Off and Prescription* (Cambridge: Cambridge University Press, 2002), 79–85.

30 Larenz, n 7 above, 105. J. Esser and E. Schmidt, *Schuldrecht: Allgemeiner Teil* (Heidelberg: C. F. M ller Verlag, 1995) 8<sup>th</sup> ed, vol I-1, 75–76, 110–111.

31 See Mankowski, n 1 above, 131.

It seems reasonable, for example, that liability for lost opportunities should be limited to what the withdrawing party could have expected during negotiations. A party would not be able otherwise to fully evaluate the risk she is assuming by entering into the negotiations. Moreover, under certain circumstances, her counter-party would be better off by being compensated for all damages she may claim – including unforeseeable lost opportunities – than by concluding the contract with the third party.

It also seems reasonable that, as in Italian law, claims for compensation for loss suffered during negotiations expire under the longer term provided for in contractual liability, rather than under the shorter term provided for in extra-contractual liability. Because of low transaction costs, parties to a negotiation are able to exchange documents and, eventually, base their claims on written evidence.<sup>32</sup>

#### IX. The role of pre-contractual agreements in negotiations

The analogy between liability arising out of negotiations and liability for breach of contract also emerges from the fact that parties are similarly able to allocate between themselves the risk of the failure of negotiations and the risk of breach of contract.

In contracts, the risk of breach may be allocated through specific contract clauses limiting, extending, or excluding liability for breach.<sup>33</sup> In torts such agreements are not normally possible because of high transaction costs.

In negotiations, the risk of some kind of harmful conduct by the other party is allocated through pre-contractual agreements. Through such agreements parties may change the allocation of risk of harmful conduct during negotiations originally chosen by the law. Where the law states that each party negotiates at her own risk,<sup>34</sup> parties may introduce some duty to compensate reasonable expenses. On the other hand, where the law states that expenses incurred during negotiations are to be compensated by the party that withdraws without justification, parties may agree that each of them will bear her own expenses should negotiations fail for whatever reason. Such pre-contractual agreements do not oblige the parties to conclude the future contract,

<sup>32</sup> See, however, Zimmermann, n 29, 79–85, on the potential drawbacks on such differentiation.

<sup>33</sup> S. Shavell, *Foundations of economic analysis of law* (Cambridge: Harvard University Press, 2004) 351–353. For a comparative account on this issue see generally Treitel, n 20 above, 208–213.

<sup>34</sup> Such a rule may be said to apply in England, as far as failure of negotiations is concerned. Whittaker, n 25 above, 45.

but rather govern the parties' conduct during negotiations and their outcome.<sup>35</sup>

Pre-contractual agreements are very common in commercial practice. They assume different names depending on the context in which they are used. Very well known are letters of intent signed during negotiations for the sale of a business.<sup>36</sup> The prospective seller, for example, may sign a pre-contractual agreement stating that, should negotiations fail, she will compensate the prospective buyer for all reasonable expenses incurred for the purpose of evaluating the business.

In France, where pre-contractual agreements (*avant contrat*) have been studied thoroughly, pre-contractual liability based on the legal rule is considered to be extra-contractual, while liability based on a pre-contractual agreement is considered to be contractual.<sup>37</sup>

Apparently and from a systematic point of view, the use of two different characterisations, depending on the existence of a contract, is perfectly understandable. However, as to the consequences, this distinction seems to be unreasonable.

It should be considered that pre-contractual agreements are not only used to obtain a different allocation of risk with respect to the allocation originally chosen by the law. They are also used to specify the duty to negotiate in good faith, as it is generally enforced by courts.<sup>38</sup> The duty of good faith is as generic as a duty can possibly be. Parties to a negotiation may be unwilling to submit their negotiations to a general clause that leaves great space to the discretion of the judge, a third party that usually decides with an incomplete understanding of the case. Therefore, they may decide to specify the duty of

35 See generally Kötz, n 25 above, 36; J. Schmidt, 'Preliminary agreements in international contract negotiation' (1983) VI *Houston Journal of International Law* 37; E. A. Farnsworth, 'Precontractual liability and preliminary agreements: fair dealing and failed negotiations' (1987) LXXXVII *Columbia Law Review* 217; C. L. Knapp, 'Enforcing the contract to bargain' (1969) XLIV *New York University Law Review* 673.

36 U. Draetta, 'Documenti pre-contrattuali nei negoziati relativi a *mergers e acquisitions*. Rassegna della prassi internazionale', in F. Bonelli and M. De Andrè (eds), *Acquisizioni di società e di pacchetti azionari di riferimento* (Milano: Giuffrè editore, 1990) 97. R. B. Lake, 'Letters of Intent: A Comparative Examination under English, U.S., French, and West German Law' (1984) XVIII *George Washington Journal of International Law & Economics* 331; M. Lutter, *Der Letter of Intent* (Cologne: C. Heymanns Verlag, 1983) 2<sup>nd</sup> ed.

37 Viney, n 7 above, 360. This view has been recently held by the *Court d'appel de Chambéry* (23 February 1998) published in (1999) CIIVI *Journal du droit international*, 188 with a comment of A. Huet.

38 J. Schmidt, *Négociation et conclusion de contrats* (Paris: Dalloz, 1982) 258–259.

good faith with detailed provisions. Such provisions, for example, could refer to the duty not to use or reveal to third parties information acquired during negotiations, not to start or continue negotiations with competing third parties, and so on.<sup>39</sup> A judge could easily find the same specific rules within the general clause of good faith and consequently apply them to the negotiations at hand, as also will be the case where the parties did not expressly provide such rules by a pre-contractual agreement. Therefore, the breach of the same duty would have certain consequences (contractual) when specifically defined by the parties, while it would have other different consequences (extra-contractual) when specifically defined by the court in interpreting the generic duty to negotiate in good faith.

#### X. The economic theory of incomplete contracts and its application to negotiations

Arguments in favor of the contractual characterisation of pre-contractual liability can be strengthened by an appreciation of the role of pre-contractual agreements with respect to the legal duty to negotiate in good faith.

The duty to negotiate in good faith can be viewed as a set of default rules left to the *ex post* specification of courts. By adopting the general clause requiring the parties to negotiate in good faith the law assumes that parties to negotiations normally benefit from some kind of regulation of this pre-contractual stage. In the law and economics literature it has been shown that parties to negotiations normally maximize the value of the future contract by adopting some kind of rule of pre-contractual liability.<sup>40</sup> Moreover, it has been shown that such a rule does not necessarily deter parties from entering into negotiations (the so-called chilling effect).<sup>41</sup> However, should parties prefer to rule their negotiations differently or to better specify the general clause of good faith, they are free to adopt a pre-contractual agreement derogating from or specifying this set of default rules. Whether parties are free to derogate completely from the duty to negotiate in good faith, or whether there are limits to their ability to do so, is still unsettled in some national laws.<sup>42</sup> This specific

<sup>39</sup> Some interesting examples are illustrated by Schmidt, n 388 above, 258–259 and Draetta, n 366 above.

<sup>40</sup> L. A. Bebhuk and O. Ben-Shahar, 'Precontractual Reliance' (2001) XXX *Journal of Legal Studies* 423; R. Craswell, 'Offer, Acceptance, and Efficient Reliance' (1996) IIL *Stanford Law Review* 481; A. Katz, 'When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations' (1996) CV *The Yale Law Journal* 1249.

<sup>41</sup> Bebhuk and Ben-Shahar, n 40 above, 453.

<sup>42</sup> For Italian law, see F. Benatti, 'Culpa in contrahendo' (1987) III *Contratto e impresa* 287, 308–309.

issue does not have to be discussed in this comment, where only the framework issue of the nature of pre-contractual liability is examined.

A reader who has some familiarity with the law and economics literature of contracts will notice that the underlying idea is to apply to the pre-contractual stage the theory of incomplete contracts.<sup>43</sup> This move is possible because harm arising out of negotiations and harm arising out of non performance both occur in contexts where transaction costs are low. In the incomplete contract of economic theory, the goal of the law is to provide the parties with a set of default rules that is presumed to maximize the value of the contract (ie the joint expected utility from its performance). By doing so, the law saves the parties the costs of having to anticipate and rule all specific circumstances that may arise and be relevant to that contract. In order to maximize the value of the contract, default rules are based on the *hypothetical will* of the parties: how parties would have normally ruled any specific circumstance, had they anticipated it and incurred the costs of providing a rule for it.<sup>44</sup>

## XI. Conclusions

It will be recalled that the extra-contractual characterisation of pre-contractual liability by the ECJ was based on the argument that this kind of liability would not arise from an obligation freely assumed, as would be the case for contractual liability, but would rather arise from the law itself. This argument is not persuasive for at least two reasons. On the one hand, contractual liability is often based on mandatory provisions and therefore is not always freely assumed, at least in a broad sense.<sup>45</sup> On the other hand, negotiating parties are free to derogate – at least to some extent – from the duty to negotiate in good faith. It could then be argued that this obligation is – at least to some extent – freely assumed.<sup>46</sup>

It seems preferable instead to qualify pre-contractual liability as contractual. This kind of liability would be based on a set of rules provided by the law

<sup>43</sup> On this theory see Ayres and Gertner, n 27 above, 87; Shavell, n 33 above, 299–301; A. Schwartz, 'Incomplete contracts', in P. Newman (ed), *The new Palgrave dictionary of Economics and the Law* (London and New York: Macmillan Reference and Stockton Press, 1998) vol II, 277; H. Schäfer and C. Ott, *Lehrbuch der ökonomischen Analyse des Zivilrechts* (Berlin: Springer, 1999) 3<sup>rd</sup> ed, 373–388.

<sup>44</sup> Schäfer and Ott, n 43 above, 397–398.

<sup>45</sup> For examples of mandatory provisions in European contract law see Kötz, n 25 above, 126.

<sup>46</sup> For more extensive critics of the present ECJ decision see Mankowski, n 1 above.

that correspond to the hypothetical will of the parties – the rules that parties to negotiations would normally adopt had they anticipated the event of harm – and therefore can be seen as based on a *hypothetical contract*.

Giorgio Afferni, Doctoral candidate (University of Genoa), L.L.M. (Harvard).