Culpa in Contrahendo: Tortious Liability, Breach of Contract or an Autonomous Legal Instrument?

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Abstract

The legal character of contract negotiations is much debated and different answers are given to the question whether disloyal behaviour committed during unsuccessful contract negotiations can be met by contractual or tort law remedies or, as a third possibility, some unique sanctions developed for this certain semi-contractual situation only. In this article, it is argued that an agreement to negotiate a contract is a contract in itself, although a very non-binding one – a pre-contract. Subsequently, breach of the parties´ duties relating to the pre-contract might be sanctioned by using contractual remedies. Most of the usual remedies, however, are not relevant, except for damages. These may be measured according to the principles on expectation interest, but in this specific situation the outcome will be almost identical with damages that are calculated according to the reliance interest. It is of course not possible to claim damages related to the contract that could have been the result if the contract negotiations had been successful.

Keywords

Culpa in contrahendo; Tortious liability; Contractual liability; Contract negotiations; Expectation interest; Reliance interest; Pre-contract; Breach of contract; Good faith; Negotiation contract

1. Introduction

The longer and the more intense the contract negotiations have been, the stronger is the need for negotiating parties to have their counterpart act loyally towards them. From time to time a negotiating party is disappointed with the other party´s behaviour and wants to take legal action. Over the last many decades, legislators and legal scholars have given much thought to the nature of liability for parties to contract negotiations and to what extent it is possible to hold a party liable for acting

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unfairly during the period in which the negotiating parties have not yet reached a final agreement.\(^1\)

In some jurisdictions it is either settled by statute law or legal practice that this kind of liability is a matter of non-contractual liability or liability in tort only\(^2\) as long as a final contract is not yet established.\(^3\) Others recognize the many similarities to contractual liability\(^4\) and claim that *culpa in contrahendo* is a legal phenomenon to be localized between the existing categories of contract and tort\(^5\) as it draws on ideas from both and is regulated by rules of its own.\(^6\) The latter point of view is especially prominent where parties are not allowed to negotiate against good faith and fair dealing (in German: *Treu und Glauben* and in French: *bonne foi*).\(^7\)

In the following a third opinion on this matter will be advocated, namely that pre-contractual liability should be considered solely contractual.\(^8\)

However, before doing so it will be introduced as exactly as possible what the subject of this article is.

This article is concerning contract negotiations between parties that cannot be characterized as consumers, in other words B2B contract negotiations. During contract negotiations such parties can act negligently, for instance by

- disclosing information given by the other party as confidential;\(^9\)
- pretending to be negotiating, but without having any real intention of reaching a final contract in order to keep the other party busy while improving its own negotiation position with other potential contract parties;\(^10\)

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\(^3\) In English law liability is hardly recognized at all but legal instruments such as fraudulent mis-representation and unjust enrichment may be used instead, cf. Paula Giliker, *A Role for Tort in Pre-contractual Negotiations? An Examination of English, French and Canadian Law* 52 International and Comparative Law Quarterly, 972 (2003).

\(^4\) This is the case for instance in German, French and perhaps Italian law too. In Italy *culpa in contrahendo* has traditionally been qualified as tort but recent case law has acknowledged that liability might apply in cases where a final agreement has been established. However, the Corte di Cassazione has in 2007 emphasized that the extent of pre-contractual liability cannot be precisely predetermined, cf. Tommaso Febbrajo, *Good Faith and Pre-Contractual Liability in Italy: Recent Developments in the Interpretation of Art. 1337 of the Italian Civil Code* 2 The Italian Law Journal 311 (2016).


\(^8\) Cf. UNIDROIT Principles 2016, Art. 1.7.

\(^9\) This is the case for instance in German, French and Italian law. See also UNIDROIT Principles 2016, Art. 1.7.

\(^10\) Alan Schwarz & Robert E Scott has proposed a similar viewpoint in their article *Pre-contractual Liability and Preliminary Agreements* 120 Harvard Law Review 661-707 (2007). See also Cartwright & Hesselink (eds), *supra* n 2, at 457-458.
-- breaking off negotiations where the other party has rendered valuable services or where a party has made investments while negotiating because it more or less rightfully relied on the other party’s intention to close the deal.\textsuperscript{11}

Consequently, I will use the terminology pre-contract and final contract,\textsuperscript{12} where the pre-contract is the agreement to negotiate while the final contract is what the parties consider will be the outcome of the negotiations if these are successful and the parties reach an agreement.

On the other hand, the importance of pre-contractual liability and its effect if a final contract is concluded will not be dealt with as this study focuses on the legal positions of the parties only where a final contract is not concluded. However, it should be kept in mind that pre-contractual liability in some jurisdictions is used as a phrase to describe unjust behaviour during contract negotiations where the parties have reached a final agreement but this is not how the wording is used in this article.

2. An Illustration: Danish Supreme Court Decision, 7 September 2007: (UfR 2007.3027 H)

To illustrate the legal considerations that \emph{culpa in contrahendo} causes I refer to a piece of Danish case law, namely a Danish Supreme Court decision of 7 September 2007 (Brunata Skovgaard A/S vs Danfoss A/S, Salg, Danmark).

The two Danish companies, Danfoss and Brunata, made a detailed written agreement to cooperate on the development and long-term manufacturing of a new type of radiator meters. In the contract the parties specified the expected number of meters to be sold over a five-year period to be 35,500. However, some technical problems arose concerning Danfoss’s developing of the meters, and after more than a year Danfoss sold the energy meter project to another company without informing Brunata. Subsequently, Brunata sued for damages and claimed that their losses amounted to DKK 29 million which was their estimated profit if the meters had been developed and produced and sold in the expected numbers.

The Supreme Court found that the agreement was a framework for future manufacturing of the meters made under the common assumption that Danfoss would be able to develop and produce the meters. However, the contract was not found to include an obligation for Danfoss to succeed in this, but only to make its best effort. Consequently, Danfoss could freely stop the development and sell the project, and therefore Brunata’s claim was not accepted.

However, the parties to the development and manufacturing contract should act in accordance with good faith and Danfoss should consequently have informed Brunata about their lack of success. Due to this, Danfoss should pay DKK 0.8 million to cover Brunata’s losses from their vain preparation of the manufacturing of the meters.

\textsuperscript{11} Cf. UNIDROIT Principles 2016, Art. 3.2.15(2).

\textsuperscript{12} This distinction can be compared with the differences between an agreement and a contract as defined in UCC §1-201(3) and (12).
This may not seem as a typical case of *culpa in contrahendo* as the parties acted according to a formal contract. The reason for using this case is anyhow to show the difficulty in discerning between contractual and pre-contractual relations. What is the real difference between the Danfoss case and pre-contractual relations when Danfoss was not obliged to develop the meters? They could – just like any party to contract negotiations – at any time leave the project and end the pre-contractual relation to Brunata without giving the latter reason to raise any kind of claims. Consequently, in my opinion the Danfoss-Brunata contract is a pre-contract very similar to the situation when parties are negotiating a contract.

If a contract in force contains a renegotiation clause, the same situation occurs. Neither party is bound to reach an agreement on a new contract or on amendments to the existing contract if this is what the renegotiation clause concerns.

Furthermore, it is impossible to start negotiations on any kind of contract without some prior consent from both parties to start the negotiations and to establish some framework for the proceedings, for instance time and place and the aim of the negotiations. Therefore, it seems quite easy to argue that all contract negotiations take place according to a special kind of open agreement, namely an agreement to negotiate.

### 3. Hypothesis

If this assumption is correct, and it will be argued that it is, it would at this point be appropriate to state the hypothetical background for the analysis to come.

The assertion of this article can be formulated as follows: *All contract negotiations are taking place according to an agreement to negotiate a contract – a pre-contract. Subsequently, pre-contractual liability must be contractual liability and contractual liability only.*

To prove the validity of this hypothesis it must be tested how the usual remedies in case of breach of contract function if pre-contractual liability is considered contractual. This test will be an examination of the legal situation if negotiations are considered to be carried out according to a contract.

### 4. Use of Remedies in Case of Breach of the Pre-contract

As with any other kind of contracts, the pre-contract may be breached by a party not only if this party has acted negligently. In case of fundamental non-performance termination, however, it is neither a relevant nor a serviceable remedy for the aggrieved party as each party at any time is free to leave the negotiations as long as a final contract has been concluded. No matter how fundamental the breach of the pre-contract, both parties may at any time end the negotiation as this is the main result.
characteristic of the negotiation contract, leaving termination as a useless tool. In other words, fundamental breach is not a condicio sine qua non if a party wants to withdraw from the negotiations.

For the same reasons remedies for avoiding a contract are useless when it comes to establishing that a pre-contract is invalid.

A right to require specific performance from the other party is not relevant either in case of breach of the pre-contract as it is legally impossible to force a party to participate in negotiations and reach an agreement on a final contract.15

To demand a proportionate reduction in price is likewise not feasible as none of the parties usually make any kind of payments to the other at the negotiation stage.

At this point, it can be concluded that the majority of the ordinary contractual remedies seem quite inefficient in relation to pre-contracts. It cannot be excluded that the remedies listed so far are applicable in some situations, but as the main rule they will not be considered at all as their usefulness is very limited. The reason for this is the distinctive character of the pre-contract. Its nature is to be informal and in many ways non-binding, but it is nevertheless a contract although very different from most other contracts.

However, still one contractual remedy remains to be considered and it is one highly relevant and applicable, namely damages.

If a party has made a breach of the pre-contract, the aggrieved party will be entitled to claim damages for its losses as is the case concerning all other kinds of contracts. Such damages should in accordance with ordinary procedures be measured so that the aggrieved party is reimbursed from the losses it has suffered due to the breach of the pre-contract17 and this contract only. Therefore, the damages will usually as a maximum cover the expenses related to the negotiations made in vain or sometimes only part of these costs depending on the circumstances. In the Danfoss case, for instance, the damages should cover the loss that could be referred to the period after Danfoss acted negligently only, because Brunata’s expenditure until that point in time can be compared to costs in relation to contract negotiations and is not a loss caused by Danfoss’ behaviour. However, the Danish Supreme Court did not take this point of view into consideration for procedural reasons.

This measuring of damages is seemingly in accordance with the principle of reliance interest but a closer look will reveal that it is also in accordance with the expectation interest principle usually reserved for contractual relations. The explanation behind this is that the pre-contract normally at any time allows the parties to leave the negotiations, and therefore a negotiating party cannot expect more from the

14 Cf. UNIDROIT Principles 2016, Art. 2.1.15(1).
15 Cf. UNIDROIT Principles 2016, Art. 7.2.2(a).
16 Damages are usually not relevant if the parties in their pre-contract has agreed on the payment of breakup fees or reverse breakup fees.
17 Cf. UNIDROIT Principles 2016, Arts 7.4.1 and 7.4.2.
18 Cf. UNIDROIT Principles 2016, Art. 3.2.16.
negotiations than the fact that negotiations are taking place without any obligation to reach consensus on a final contract.19

As shown, the outcome of breaching a pre-contract when looked upon as a contract in itself resembles what will follow from using tort rules. However, the result will not be identical in every case as also pure contractual loss might be awarded to the injured party in accordance with usual contractual practice.20

5. Damages Related to the Final Contract21

Damages measured in accordance with what could have been the party’s profit had the final contract been concluded cannot be accepted as the starting point. This kind of damages might be relevant only in the very rarely occurring situations where the culpa in contrahendo has caused the parties not to conclude a final agreement, and only where it can be said with almost absolute certainty that the breaching party by acting negligently avoids being bound by the final contract.

As an example, this kind of damages might be awarded where tenders have been submitted in a procurement process. If the conditions for the submission of bids are designed in such a way that the buyer is obliged to accept a bid meeting the criteria but fails to do so, damages for a loss of chance of achieving the contract seems fair and obtainable.22

In that situation it might just as well be stated that the parties have concluded a final contract but a contract that will not be executed because the negligent party acts in a way that the breach of contract will be anticipated from the very beginning.23 Consequently, it may be said that damages measured in accordance with the expected outcome of the final contract are irrelevant when analysing the legal effects of pre-contracts other than the rare ones mentioned at the beginning of this paragraph.

To conclude the analysis of the use of contractual remedies in case of breach of a pre-contract, it can be said that no obstacles have been found. All contractual remedies may be dealt with coherently and logically if pre-contractual liability is considered to be contractual.

20 Regarding the restrictive approach to pure economic loss in English law of tort see Giliker, supra n 4, at 974.
21 Such damages are expressly excluded in the French code civil, Art. 1112(2).
22 Cf. most of the authors who has contributed to Duncan Fairgrieve and François Lichère (eds), Public Procurement Law – Damages as an Effective Remedy (Oxford and Oregon: Hart Publishing, 2011).
23 Cf. UNIDROIT Principles 2016, Art. 7.3.3.
6. What are the Advantages of Regarding Culpa in Contrahendo as Contractual Liability?

When suggesting an alternative approach on how to handle the legal effects of pre-contractual liability, one should also take into consideration whether the new approach actually will be helpful when solving legal disputes concerning pre-contractual liability. The benefits, from this author’s point of view, are listed in the following.

As it has been previously revealed almost all cases will as a maximum lead the aggrieved party to claim damages to compensate for the negotiation costs paid in vain, compare for instance the Danfoss case. Decisions made in accordance with the hypothesis that *culpa in contrahendo* is contractual will normally result in the same legal effects as is the situation in case law today. However, the reasoning will not be founded on the complicated and artificial legal constructions that follow from claiming that contract negotiations are not based on an agreement contract at all or on a mixture of contract and tort. The point of view argued here simply implies the use of existing and well established principles of contractual liability and, furthermore, principles that are broadly recognized and accepted in most jurisdictions and exist without the need for the legislator to be involved in the rule-making process.

The contractual liability procedure makes it superfluous to consider whether or not a formal agreement on negotiating has been made, and breaches of pre-contracts and conditional agreements can be dealt with in the same way, cf. the Danfoss case. This is because the pre-contract will lose its binding effect once the implicit condition – that the parties want to pursue the aim of reaching agreement on a final contract – is not fulfilled because one of the parties breaks off the negotiations.

Focus will be on the actual losses suffered in the negotiation process due to one party’s behaviour against good faith instead of whether the dispute is a matter of reliance or expectation interest as this often wrongfully leads to discussions concerning if the damages should include the expected outcome of the hoped-for final contract, cf. the Danfoss case.

If the *culpa in contrahendo* is dealt with as contractual, it will also be possible to avoid disputes on whether pure economic losses can be taken into consideration without reservations. Discussions on the conditions for enrichment are not relevant either as the matter can be looked upon as a question of whether the pre-contract should be interpreted as a contract giving one of the parties a contractual right to be remunerated for services or goods rendered during the negotiations.

Furthermore, breaches of the pre-contract is not a matter of whether a non-contractual duty to act in accordance with good faith and fair dealing exists, but a question of whether the pre-contract in question has been breached by one of the negotiating parties.

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Overarching all these positive effects is the fact that the contractual approach supersedes the previous scholarly discussions on whether to view the pre-contractual liability as tort or as something between tort and contract – a quasi-contractual relationship. The point of view is that either a contract has been established or it has not.

Finally, uncertainty regarding how disagreements on the liability to pay damages should be dealt with in relation to determining which law is applicable could be avoided.25

7. Conclusion

Of course, there might be disadvantages of applying the contractual approach to culpa in contrahendo. However, even though this author is most probably prejudiced, it is hardly possible to see any, except from the one that the pre-occupying opinion in many jurisdictions is to view the matter differently. Therefore, the traditional thinking in this area might prevent the contractual approach from being widely recognized.

The fact that the parties are negotiating a contract that has not yet come into existence seems in general to be overshadowing the fact that they already – and frequently in writing – have agreed to negotiate and, furthermore, have agreed on the framework for the negotiations. Such agreements to negotiate should not be characterized as anything but contracts, although of a very special and open kind, and it is broadly accepted that they impose certain contractual duties on the parties just as is the case regarding renegotiation contracts. As such contractual duties may be breached it therefore seems most obvious to meet such breaches with contractual remedies of which damages, as the main rule, will be the only relevant sanction.

25 Cf. e.g. preamble No. 10 of regulation (EC) No. 593/2008 on the law applicable to contractual relations (Rome I) which refers all culpa in contrahendo matters to be dealt with by Art. 12 of regulation (EC) No. 864/2007 on the law applicable to non-contractual obligations (Rome II). The latter sets specific rules for non-contractual obligations ‘arising out of dealings prior to the conclusion of a contract, regardless whether the contract was actually concluded or not.’ As the Danfoss case shows, it will from time to time be difficult to establish exactly when an agreement to negotiate should be considered a contract in this relation.