A Comparative Study of Good Faith, Fair Dealing, and Precontractual Liability

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I. INTRODUCTION

> "If good faith has been taken away, all intercourse among men ceases to exist."[1]

The continued growth of today's global market demands resolution of certain conflicts between different legal systems in order to facilitate contracts between multi-national parties. One often discussed area of tension is precontractual liability. Both common law and civil law systems impose a duty of good faith on the performance or enforcement of an existing contract.[2] The question is whether a duty of good faith and fair dealing applies to precontractual relationships.

Civilian jurisdictions generally impose a duty of good faith in precontractual negotiations. French legal theory maintains that such a duty exists.[3] On the other hand, it is generally agreed that common law theory denies the existence of a duty of good faith in the absence of an enforceable contract. Although American legal theory argues that there is no precontractual duty, remedies for precontractual misbehavior are in fact provided by promissory estoppel and various tort doctrines. This Article argues that American common law, through promissory estoppel, has *de facto* adopted a theory imposing an obligation to refrain from bad faith in negotiations and that this obligation closely resembles both the usual implied covenant of good faith and the civilian concept of liability for precontractual bad faith as it is used in France.

The Article begins by defining the duty of good faith under French[4] and American law and discussing the interplay between the underlying contract and tort theories. The second part of the Article will focus on the point at which the duty may arise in the course of negotiations. Third, the measure of damages under both schemes will be discussed. Finally, the differences will be examined in light of the good faith requirement

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1. HUGO GROTIUS, DE JURE BELLI AC PACIS BOOK III (1625), *quoted in* J.F. O'CONNOR, GOOD FAITH IN INTERNATIONAL LAW 56 (1991).

2. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); U.C.C. § 1-203, C. Civ. (France) art. 1134 al.3; BGB art. 242 [German Civil Code]; International Institute for the Unification of Private Law, Principles of International Commercial Contracts art. 1.7 (1994) [hereinafter Unidroit Principles].

3. BARRY NICHOLAS, THE FRENCH LAW OF CONTRACT 48, 71 (2d ed. 1992).

4. French law does not follow the German *culpa in contrahendo* approach as it has developed from German legal scholar Rudolph von Jhering's article, *Culpa in contrahendo oder Schadensersatz bei nichtigen oder nicht zur Perfection gelangten Vertrögen* (*Culpa in Contrahendo or Damages for Contracts that are Void or not Brought to Perfection*), *in* 4 JAHRBUCH FÜR DIE DOGMATIK DES HEUTIGEN RÖMISCHEN UND DEUTSCHEN PRIVATRECHTS 1 (1981) discussion *infra* text accompanying notes 83-91.

delineated in the Vienna Sales Convention, article 7,[5] and as expanded upon in Unidroit principles articles 1.7 and 2.15.[6] The comparison of French and American approaches to the existence and nature of a precontractual duty of good faith shows that efforts to harmonize the two approaches are likely to be successful once attorneys become familiar with the scope and nature of such a duty. The Article will conclude with some recommendations for facilitating the development of law in both jurisdictions.

II. THE CONCEPT OF GOOD FAITH

In order for a comparative lawyer to gain a clear understanding of any particular concept, he must have some general understanding of the principles underlying the system of law he is studying, how those principles interact, and how the concept he is studying fits into the general scheme of things. Even the most basic principles of law, such as offer and acceptance, can differ from country to country.[7] In order to understand why lawyers from common law countries are uncomfortable with the concept of a precontractual duty of good faith, one must begin by understanding what common law views as the fundamental principles of contract law.

A. United States Law

Since its development in the latter part of the eighteenth century, common law has emphasized consideration and the parties' intent to be bound as necessary to the enforcement of a contract, rather than emphasizing the theory that promises are binding as a matter of fidelity

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5. U.N. Conference on Contracts for the International Sale of Goods, Final Act April 11, 1990, U.N. Doc. A/Conf. 97/18, reprinted in S. Treaty Doc. No. 98-9, 98th Cong., 1st Sess. and 19 I.L.M. 668 (1980) [hereinafter Vienna Sales Convention] ("in the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.").

6. Unidroit Principles Art. 1.7 provides that "each party must act in accordance with good faith and fair dealing in international trade," and "the parties may not exclude or limit this duty." Art. 2.15 provides:

> (1) A party is free to negotiate and is not liable for failure to reach an agreement.
> (2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.
> (3) It is bad faith, in particular, for a party to enter into or continue negotiations intending not to reach an agreement with the other party.

7. Steven A. Mirmina, *A Comparative Survey of* Culpa in Contrahendo*, Focusing on Its Origins in Roman, German, and French Law, as Well as Its Application in American Law*, 8 CONN. J. INT'L L. 77, 79 (1992).

and honesty.[8] In emphasizing consideration and intent, common law assumes that there is a clear distinction between the relationship called a "contract" and the relationship between those who have merely entered negotiations looking to the formation of a contract.[9] The converse to the proposition that creation of a contract relation results in the immediate existence of rights is that until a contract has been created, no contract-related rights exist.[10] Courts that do not recognize a middle ground between a completed contract and no contract at all are confronted with a dilemma when the unreasonable behavior of one party to negotiations causes damage to the other party.[11] They become torn between the black letter law which dictates that no contract was formed and the desire to provide a just remedy to the party damaged.[12]

The duty of good faith attaches only with the creation of a contract, and has traditionally been described as "an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract."[13]

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8. JAMES GORDLEY, THE PHILOSOPHICAL ORIGINS OF MODERN CONTRACT DOCTRINE 10-11 (1991).

9. Charles L. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 674 (1969). *See* JOSEPH M. PERILLO & HELEN HADJIYANNAKIS BENDER, 2 CORBIN ON CONTRACTS: FORMATION OF CONTRACTS § 5.1 (1995) (The term "consideration" has been used in a number of ways. While it has been used to cover all the reasons deemed sufficient to render a promise enforceable, current usage has restricted it to its narrow meaning of bargained-for exchange).

10. Knapp, *supra* note 9, at 674.

11. *Id*. at 673.

12. Mirmina, *supra* note 7, at 94.

13. Kirke La Shelle Co. v. Paul Armstrong Co., 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933). This language describing the duty of good faith has since become boilerplate. *See* STEVEN J. BURTON & ERIC G. ANDERSEN, CONTRACTUAL GOOD FAITH: FORMATION, PERFORMANCE, BREACH, ENFORCEMENT §§ 2.2.2.1-.2 (1995).

Where negotiations succeed and result in an enforceable contract; however, a party that has behaved improperly can be deprived of the bargain on grounds of misrepresentation, duress, undue influence, or unconscionability. A number of cases illustrate that the duty of good faith may be applied to remedy precontractual bad faith after an enforceable contract has been created. Two such landmark cases are *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917) (Benjamin Cardozo, J.), and *Kirke La Shelle*. In the former case, Lady Duff-Gordon, a well-known fashion designer, agreed that Wood would have the exclusive right to market goods bearing her endorsement. In return, Wood was to give her a portion of the revenues. Lady Duff-Gordon subsequently sold her designs to others, and Wood sued, arguing breach of contract. Judge Cardozo disagreed with Duff-Gordon's argument that her promise was not supported by consideration and hence not enforceable, holding that Wood had impliedly promised to use reasonable efforts to market and place the goods and that while "[a] promise may be lacking . . . yet the whole writing may be 'instinct with an obligation,' imperfectly expressed . . . . We are not to suppose that one party was to be placed at the mercy of the other." 222 N.Y. at 91, 118 N.E. at 214. The reasoning used by Judge Cardozo was very similar to that underlying Jhering's *culpa in contrahendo*, and he may have been familiar with Jhering's work. Mirmina, *supra* note 7, at 102 & n.58.

In contrast, courts traditionally accord parties the freedom to negotiate without risk of precontractual liability under the common law's "aleatory view" of negotiations: a party who enters negotiations in the hope of the gain that will result from ultimate agreement bears the risk of whatever loss results if the other party breaks off the negotiations.[14] This is sometimes referred to as "arm's length" dealings,[15] or the rule of "*caveat emptor*."[16]

In the last few decades, the "on-off" view of contract creation and the duty of good faith has been modified by a more sophisticated view of the relational process of doing business as courts and legal theorists attempt to make contract doctrine responsive to the different objectives and forms of modern contractual behavior.[17] For example, traditionally an agreement to enter into an agreement upon terms to be afterwards settled was conclusively considered to be a contradiction in terms.[18] As a by-product of the changing view of contracts, courts have become more willing to enforce an interim agreement or a contract to bargain, depending upon the express or implied intent of the parties and the specificity of that agreement.[19] Along with this willingness at least to

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14. E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 221 (1987).

15. *See* Mirmina, *supra* note 7, at 93.

16. *See* Yoav Ben-Dror, *The Perennial Ambiguity of* Culpa in Contrahendo, 27 AM. J. L. HIST. 142, 193 (1983).

17. *See* Richard E. Speidel, Afterword: *The Shifting Domain of Contract*, 90 Nw. U. L. Rev. 254, 255 (1995) (discussing various methods used in negotiating agreements, including (1) fully documented agreements that have been negotiated in whole or in part, (2) agreements involving little or no negotiation and evidenced by highly structured documents drafted on a take it or leave it basis, and (3) contractual relationships that develop over time and consist of relatively incomplete written agreements. In these long-term relationships, performance is dependent to a much greater extent on continuing good faith negotiation, cooperation, and the flexibility of the parties); *see also* Jay M. Feinman, *Relational Contract and Default Rules*, 3 S. CAL. INTERDISCIPLINARY L.J. (1994) (discussing relational contract theory); Juliet P. Kostritsky, *Bargaining with Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule for Precontractual Negotiations*, 44 HASTINGS L.J. 621 (1993). *But see* Wendell H. Holmes, *The Freedom Not to Contract*, 60 TUL. L. REV. 751, 791-796 (1986) (discussing limitations of relational contract theory).

18. Ridgway v. Wharton, 10 Eng. Rep. 1287, 1313 (H.L. 1857) (Lord Wensleydale) (quoting Farnsworth, *Precontractual Liability, supra* note 14, at 221).

19. *See generally* Knapp, *supra* note 9 (arguing for the enforcement of contracts to bargain). Probably the most renowned of these cases is *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768, 790-92 (1987) (showing party's actions intent to be bound, despite contrary language in preliminary agreement). *See* discussion *infra* text accompanying nn.133-138; *see also* Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 72 (2d Cir. 1989) (language in preliminary agreement showed intent not to be bound).

entertain the enforceability of a contract to bargain has come discussion of, and in some cases enforcement of, the duty of good faith.

While current contract theory still denies the existence of a duty of good faith in negotiation, it consistently mentions that bad faith in negotiation may give rise to sanctions under the doctrine of promissory estoppel or other theories.[20] Thus, comprehensive analysis of precontractual liability necessarily involves discussion of the concept of good faith. Such discussion will not only provide insight into the nature of the concept, but will also provide a key to considering whether the duty itself may already be largely present under existing theories such as promissory estoppel.

1. Definition and Statutory Law

The majority of American jurisdictions recognize the implied covenant to perform a contract in good faith as a general principle of contract law,[21] and find that it is not a strange concept or one inherently difficult to apply: "[t]he contractual duty of good faith is . . . not some newfangled bit of welfare-state paternalism or . . . the sediment of an altruistic strain in contract law."[22] The Restatement (Second) of Contracts begins its discussion with the traditional, objective standard that "every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[23] Similarly, the U.C.C. provides that the implied covenant in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.[24] The same two obligations of honesty in fact and observance of reasonable commercial standards of fair dealing also apply to contracts

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20. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. c (1981); BURTON & ANDERSEN, *supra* note 13, § 8.2.2.

21. BURTON & ANDERSEN, *supra* note 13, § 2.2.3.3. *But see* Renaissance Yacht Co., Inc. v. Stenbeck, 818 F. Supp. 407 (D. Ct. Me. 1993) ("Whether such an implied covenant [of good faith] exists under Maine law has been the subject of much confusion. . . ."); English v. Fischer, 660 S.W.2d 521, 522, 27 Tex. Sup. J. 74 (Tex. 1983) ("A basis for the judgments below was the adoption of a novel theory of law enunciated only by California courts. That theory holds that in every contract there is an implied covenant [of good faith and fair dealing]. . . . This concept is contrary to our well-reasoned and long-established adversary system which has served us ably in Texas for almost 150 years.").

22. Market Street Associates Ltd. Partnership v. Frey, 941 F.2d 588, at 696 (7th Cir. 1991), per Posner, *quoted in* E. Allan Farnsworth, *Good Faith in Contract Performance* in GOOD FAITH AND FAULT IN CONTRACT LAW 153, 155 (Jack Beatson & Daniel Friedmann, eds. 1995); *see also* Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980).

23. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

24. U.C.C. § 2-102(1)(b).

within the scope of Articles 2A, 3, 4, and 4A (leases, negotiable instruments, bank deposits and collections, and funds transfers, respectively).[25]

A comprehensive definition of good faith has been termed difficult to set forth because the purpose of the doctrine is to prohibit improper behavior across the entire range of contracts, and thus definitions of good faith have been criticized as either too abstract or applicable only to specific contexts.[26] Nevertheless, good faith has been described as "decency, fairness or reasonableness in performance or enforcement of a contract" and "an honest intention to abstain from taking unfair advantage of another, through technicalities of law, by failure to provide information or to give notice, or by other activities which render the transaction unfair."[27]

In contrast to the broader objective standard described above, in some situations, the scope of the duty of good faith is limited to the subjective duty to act with honesty in fact. The U.C.C. uses this as its base standard, stating that "[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement,"[28] and that this duty means "honesty in fact in the conduct or transaction concerned."[29] The U.C.C. further provides that this duty may not be waived.[30] At the very least then, good faith is a standard of honesty imposed on every party to a contract.[31] Under this limited, subjective standard, parties are only expected to contract honestly and in their own self-interest.[32] The "arm's length" standard still applies. The only requirement is that a party make an honest judgment in his own self-

25. *Id.* § 3-103 & cmt. 4.

26. U.S. Genes v. Vial, 143 Ore. App. 552, 559, 923 P.2d 1322 (Ore. App. 1996).

27. Schaller v. Marine National Bank of Neenah, 131 Wis.2d 389, 402, 388 N.W.2d 645 (Ct. Apps. Wis. 1986) (citations omitted).

28. U.C.C. § 1-203.

29. *Id.* § 1-201(19).

30. *Id.* § 1-102(3),("[t]he effect of provisions of this Act may be varied by agreement, except . . . that the obligations of good faith, diligence, reasonableness, and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.").

31. E. Allen Farnsworth, *On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1, 8 (1984); *see also id*. The duty of good faith and fair dealing can sometimes be confused with a requirement of best efforts. Best efforts is a standard that has diligence as its essence and is only imposed on contracting parties that have undertaken such performance.

32. Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies Ltd., 970 F.2d 273, 280 (7th Cir 1992).

interest. It "does not require parties to behave altruistically . . . [or to] proceed on the philosophy that I am my brother's keeper . . ., [a philosophy that] may animate the law of fiduciary obligations. . . ."[33] The "honesty in fact" requirement of U.C.C. § 1-201(19) rewards the pure heart rather than penalizing the empty head.[34] However, honesty alone is often not enough under common, as opposed to statutory, law.

2. Common Law Duty of Good Faith

In contrast to the limited standard given in U.C.C. § 1-203, common law extends the duty beyond the express terms of a contract to include a duty to refrain from conduct that destroys the other party's reasonable expectations and its right to receive the fruits of a contract. A recent case provides a clear illustration of the nature and extent of this duty. In *Sons of Thunder, Inc. v. Borden*, *Inc.*, Borden decided that it wanted a more secure and steady supply of clams and decided to contract with long-time captain Donald DeMusz who managed Borden's fleet of fishing boats.[35] DeMusz was to buy and run a total of two boats. One contract provided for a boat to be rigged to shuck clams at sea, an innovation aimed at avoiding the expense of disposing of the empty clam shells.[36] The shucking equipment was to be leased by Borden to DeMusz's corporation

33. *Id.*

34. R. Speidel, *The Last Ten Years: What Your Students Know that You Should Know Too: The "Duty" of Good Faith in Contract Performance and Enforcement*, 46 J. LEGAL ED. 537, 540 (1996).

As was indicated above, the U.C.C. describes two standards: a lower one of honesty in fact which is generally applicable to all contracts within its scope, and a higher, objective standard that includes fair dealing as described in 2-201(b), commensurate with the common law duty. In 1996, the revision of Articles 3 and 4 extended the higher standard to articles 3 and 4, but prior to that time, the U.C.C. did not specify anything other than the honesty-in-fact standard. As a result, there have been cases distinguishing between the two standards and holding that where the U.C.C. did not specifically apply the higher standard, the honesty-in-fact standard displaced the common law duty because this displacement served the U.C.C.'s purposes to simplify, clarify, and modernize the law governing commercial transactions and to make law uniform among the various jurisdictions. *See, e.g.*, First Interstate Bank of Oregon, N.A., v. Wilkerson, 128 Ore. App. 328, 332, 876 P.2d 326, 328 (Ore. App. 1994). It is by no means clear that the § 1-203 definition always displaces the common law, *see* Sons of Thunder, Inc. v. Borden, Inc., 148 N.J. 396, 690 A.2d 575 (N.J. 1997) (finding that Borden was not "honest in fact," as required by the U.C.C., and also finding that it had breached the implied covenant of good faith found in New Jersey's common law). There have also been cases limiting the duty in a contract-to-bargain situation to this lower honesty-in-fact standard. *See, e.g.*, *Chocolate Chip Cookie*, 970 F.2d at 280; Schwanbeck v. Federal-Mogul Corp., 31 Mass. App. Ct. 390, 578 N.E.2d 789 (Mass. App. 1991) (discussed *infra* text accompanying notes 151-152).

35. Sons of Thunder, Inc. v. Borden, Inc., 148 N.J. 396, at 399-400.

36. *Id.*

and to be installed on DeMusz's boat THE JESSICA LORI.[37] In exchange, THE JESSICA LORI was to offer to Borden all of its shucked clam meat at sixty cents per pound.[38]

Another contract provided for a second boat. THE SONS OF THUNDER was to be much larger than the JESSICA LORI and capable of going to sea in bad weather.[39] Borden agreed to purchase a minimum of 240 cages of ocean quahogs (clams) per week from THE SONS OF THUNDER for one year at the market rate.[40] DeMusz's corporations incurred substantial debt to finance the rerigging of THE JESSICA LORI as well as to buy both boats, and Borden was aware of this indebtedness;[41] DeMusz also had personally to guaranty the loans.[42]

It took some time to install the shucking equipment on THE JESSICA LORI, and in the intervening period, Borden's management changed.[43] The new management refused to buy the specified minimum from THE SONS OF THUNDER, and a mid-level manager tried to extort kickbacks from THE SONS OF THUNDER.[44] Shortly after THE JESSICA LORI became operational, Borden started charging DeMusz for the shucking equipment, refused to pay the agreed-upon price, and then stopped purchasing the processed clam meat from THE JESSICA LORI.[45] When DeMusz tried to sell THE JESSICA LORI's clam meat to other suppliers, Borden charged a rental fee for use of the shucking equipment despite the fact that no such fees were provided for in the contract.[46] Finally, Borden terminated both contracts.[47] DeMusz was financially devastated, brought suit, and won at trial.[48]

The New Jersey Supreme Court considered the entire course of dealings between the two parties and affirmed the jury's finding that Borden had breached its contract and also that it had breached its obligation of good faith and fair dealing.[49] The court noted that Borden knew that THE SONS OF THUNDER was financially dependent on the

37. *Id.,* 148 N.J. at 401, 404.
38. *Id.*, 148 N.J. at 401.
39. *Id.*
40. *Id.*, 148 N.J. at 402.
41. *See id.*, 148 N.J. at 400-02.
42. *Id.,* 148 N.J. at 403-04.
43. *Id.*, 148 N.J. at 404.
44. *Id.*, 148 N.J. at 405-06.
45. *Id*., 148 N.J. at 406.
46. *Id.*
47. *Id*., 148 N.J. at 407.
48. *Id.*
49. *Id.*, 148 N.J. at 424-425.

Borden contract, yet Borden continuously breached that contract by never buying the agreed-upon minimum quantity of clams, leaving SONS OF THUNDER with insufficient revenue to support its financing.[50] Borden also knew DeMusz's two corporations were financially dependent on each other, and that if one company failed, the other would most likely fail as well. Yet Borden breached the agreement with THE JESSICA LORI in addition to breaching the one with THE SONS OF THUNDER.[51] Furthermore, Borden knew that DeMusz would have trouble selling the JESSICA LORI's shucked clam-meat to anyone other than Borden.[52] Despite knowing the desperate financial straits DeMusz was in, Borden imposed uncontracted-for rental fees and pressured DeMusz to repay a comparatively small advance.[53] Thus, the court concluded that Borden's conduct not only breached the contracts with DeMusz, but also breached the duty of good faith by destroying his reasonable expectations that the contracts would be profitable and preventing him from receiving the fruits of those contracts.[54]

In this case, the duty of good faith extended to cover not only those duties specifically delineated in the contracts, such as the *de minimis* purchases and minimum pricing provisions, but also ancillary behavior such as the additional charges and pressure to repay the advance. Given that Borden knew that DeMusz had gone far out on a financial limb in order to purchase and operate the boats according to Borden's requirements, this behavior made it impossible for DeMusz to obtain the benefits that the contract was to afford him. Thus, the New Jersey Supreme Court implicitly held that the duty of good faith and fair dealing extends to cover extra-contractual behavior related to the ability of a party to obtain the anticipated benefits of a contract. This analysis is consistent with Professor Farnsworth's suggestion that the obligation to perform a contract in good faith should be understood to further the agreement of the parties and that the parties to a contract must cooperate so that neither of them will be deprived of his reasonable expectations;[55] however, the court's careful consideration of the context of the contract as well as its terms expands upon this analysis.

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50. *Id.*, 148 N.J. at 424.
51. *Id.*
52. *Id.*, 148 N.J. at 425.
53. *Id.*
54. *Id.*
55. E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 669 (1963).

Since Professor Farnsworth formulated this reasonable expectations theory, other scholars have analyzed case law somewhat differently. Professor Summers noted that in most instances courts do not delineate what constitutes good faith, but rather delineate a duty to refrain from conduct showing bad faith.[56] The function of good faith is not to contribute positively to the characterization of anything, but to exclude bad faith behavior. This excluder analysis was adopted in comment (d) to the Restatement (Second) of Contracts § 205:

> A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.[57]

This description of good faith through excluder analysis is, in essence, a list of intentional torts.

Similarly, in the context of precontractual negotiations, Professor Palmieri describes seven acts that may constitute a bad faith failure to disclose, five of which are pertinent to this discussion: (1) when material facts are actually concealed; (2) when prior misstatements are intentionally left uncorrected; (3) when despite specific request, material facts are not disclosed; (4) when material facts are withheld in the context of a fiduciary relationship; and (5) when the failure to disclose relates to material facts the other party reasonably could not discover on its own.[58] These five examples of precontractual bad faith describe a subjective, intent-based standard, implying some degree of scienter on the part of the malfeasor: he knew or should have known that the other party needed certain information and nevertheless did not disclose it.[59] If these examples are coupled with causation and damages, the party harmed will

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56. Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 200-207 (1968); *see also* Mary E. Hiscock, *Is the UCC Dead, or Alive and Well?*, 29 LOY. L.A. L. REV. 1059, 1066 (1996).

57. These illustrations, appropriate where a contract is already in place, were borrowed from Professor Robert Summers's article *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 200 (1968).

58. Nicola W. Palmieri, *Good Faith Disclosures Required During Precontractual Negotiations*, 24 SETON HALL L. REV. 70, 120 (1993). The last two acts are specific to certain industries, and do not substantially illuminate the nature of good faith: (6) in the context of negotiations surrounding insurance, suretyship, or labor relations agreements; (7) where statute specifically requires disclosure. *Id.*

59. The last two examples are *sui generis*, driven by affirmative law or statute, and do not directly add to a definition of good faith.

likely have a cause of action for misrepresentation.[60] Flipping this excluder-based definition of precontractual bad faith back from the dark side, a precontractual duty of good faith might be described as an absence of any wrongful motive, dishonesty, or action motivated by impermissible reasons.[61] A comparison of the two lists of examples (Summers' and Palmieri's) shows that they parallel one another, the difference between the two being that Palmieri's examples of precontractual bad faith involve definite mendacity, while Summers' examples of bad faith in the presence of a contract describe abusive behavior that may or may not involve mendacity.

The study of what constitutes good faith in a contractual situation has gone beyond excluder analysis. Further case study led to Professor Burton's conclusion that good faith performance of a contract occurs when a party with discretion in performance exercises that discretion within the scope of the parties' justifiable expectations.[62] Part of analyzing whether performance has been in good faith is considering what opportunities the parties have foregone in making their agreement, so that any promisor who uses discretion in performance to recapture foregone opportunities is in breach of contract.[63] "Good faith limits the exercise of discretion in performance conferred on one party by the contract;" therefore, it is bad faith to use discretion "to recapture opportunities foregone on contracting," as determined by the other party's expectations or, in other words, to refuse "to pay the expected cost of performing."[64] The examples of bad faith behavior described by Professor Summers include this type of abuse of discretion and evasion of the consequences of agreeing to contract.

As applied to *Sons of Thunder*, this means that Borden's rejection of DeMusz's clams was a bad-faith attempt to recapture a foregone opportunity, as was its charging rental fees for the JESSICA LORI's shucking equipment. Borden further demonstrated bad faith in its reckless disregard of DeMusz's financial dependency on the Borden

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60. The elements of the tort of misrepresentation are frequently stated as (1) a false representation made by the defendant, (2) scienter on the part of the defendant (the defendant knew or should of known that the representation was false), (3) intent on the part of the defendant to induce the plaintiff to rely on the misrepresentation, (4) reasonable reliance on the part of the plaintiff, (5) damage to the plaintiff caused by his acting or refraining from acting in reliance on the misrepresentation. W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 105, at 728 (5th Ed. 1984).

61. *See* BURTON & ANDERSEN, *supra* note 13, § 3.3, at 74.

62. *Id.* § 2.2.3.3.

63. *Id.* § 2.3.1

64. Burton, *supra* note 22, at 369.

contracts. By causing DeMusz to go out on a financial limb, Borden gave up its opportunity to disregard that financial dependency.

While this discretion-in-performance standard explains decisions dealing with relational contracts such as *Sons of Thunder* in a much more satisfactory way than do prior standards because it focuses on the entire context of an agreement or series of agreements, it still hinges on the common law theory that the birth of a contract is an immaculate conception and that there is no duty in the absence of an enforceable contract. The general view remains that negotiations are essentially aleatory in nature, that any losses incurred on account of their failure are foreseeable, and thus remedies for injuries caused by failed negotiations remain the exception.[65]

The story of the dealings between the parties in *Sons of Thunder* indicates that the contractual duty of good faith is not limited to the terms of the contract itself, but intertwined with the whole course of the parties' dealings. Likewise, the birth of a contract is not always limited to the actual signing, but at times involves a whole course of dealings or a series of precontractual agreements. Recognition of this reality within the confines of a discretion-in-performance definition requires very little modification of the theory in order to apply this definition to a precontractual setting: a breach of good faith occurs if negotiations have proceeded to the point that a party's pursuit of an opportunity constitutes an abuse of its discretion, and this abuse causes damage to the other party. This proposal, because it is premised on the incremental nature of negotiations, may avoid some of the pitfalls of instrumentalist theories.[66] The requisite degree of both bad-faith behavior and damages would necessarily be higher in a precontractual setting than with an existent contract before remedy would be granted.

B. Civil Law

In contrast to common law, which has at times theorized that ideas of morality should not be confused with legal principles,[67] civil law

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65. BURTON & ANDERSEN, *supra* note 13, § 8.3.2.

66. *See* Juliet P. Kostritsky, *Reshaping the Precontractual Liability Debate Beyond Short Run Economics*, 58 U. PITT. L. REV. 325, 330-31 (1997).

67. "The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it—and nothing else." The Path of the Law, Address by Mr. Justice Holmes, then of the Supreme Court of Massachusetts (Jan. 8, 1897), reprinted in 2 THE WORLD OF LAW 614, 618-19 (E. Londeon ed. 1960), *quoted in* Tête, *infra* note 68, at 58. *See also* Ben-Dror, *supra* note 16, at 154, 173; Michael B. Metzger & Michael J. Phillips, *Promissory Estoppel and Reliance in Illusory Promises*, 44 SW. L.J. 841, 842-845 (1990).

traditionally recognizes a duty of good faith in both precontractual and contractual situations. This duty developed out of the Roman theory of *bona fides*.[68] As was done with common law, the underlying concepts of civil law will be described in order to place the civilian concept of good faith in proper context.[69]

In a civilian context, a contract is one of several different kinds of legally enforceable obligations. Obligations can arise from agreement as in a contract, but they can also arise automatically by operation of law, as with a tort.[70] An obligation is "a legal relationship whereby a person, called the obligor, is bound to render a performance in favor of another, called the obligee. Performance may consist of giving, doing, or not doing something."[71] A conventional obligation or contract is defined as an agreement wherein one or more people oblige themselves to give, to do, or not to do something for one or more people.[72] The French *Code Civil* lists four requirements essential for a contract to be valid: consent,

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68. Saul Litvinoff, *Good Faith*, 71 TUL. L. REV. 1645, 1652-53 (1997); William T. Tête, *Tort Roots and Ramifications of the Obligations Revision*, 32 LOY. L. REV. 47, 56 (1986).

69. The term "civil law" originally referred to the eleventh-century rediscovery of Justinian's compilation of Roman law, the Corpus Iuris Civilis, that was substituted for local law in the mergent states and cities of continental Europe. NICHOLAS, *supra* note 3, at 1. The heart of the difference between civil and common law is that civil law is the law of the book as elaborated in the universities, while common law is the law of the case, created by the courts. *Id.* at 2. Judicial decisions have much less importance in the civilian world, and while courts do follow previous decisions, no court is legally required to do so and there is no system of binding precedent. Law is regarded as a system of substantive, legislated rules, complete and intellectually coherent. *See e.g.* LA. CIV. CODE art. 1 ("The sources of law are legislation and custom") & comments (a)-(c). "According to civilian doctrine, legislation and custom are authoritative or primary sources of law. They are in contrast to persuasive or secondary sources of law, such as jurisprudence, doctrine, conventional usages, and equity, that may guide the court in reaching a decision in the absence of legislation and custom." LA. CIV. CODE art. 1, comment (c).

70. *See* CODE CIV. art. 1370. *See also* LA. CIV. CODE art. 2292.

71. LA. Civ. Code art. 1756. Types of obligations listed in the French Civil Code include (1) conventional obligations or contract, CODE CIV. art. 1101 (*see also* LA. CIV. CODE art. 1906)); (2) natural obligations, CODE CIV. art. 1235 (natural obligations are those that arise from a particular moral duty and are not enforceable but that cannot be reclaimed once performed. LA. CIV. CODE arts. 1760, 1761; (3) quasi-contracts, CODE CIV. art. 1371, 1372 (a quasi-contract may arise when someone undertakes of his own accord to manage the affairs of another and is therefore not a contract in fact. LA. CIV. CODE arts. 2293, 2295); and (4) offenses and quasi-offenses (*délits* and *quasi-délits*) or torts that give rise to an obligation to repair the damage caused, CODE CIV. arts. 1382, 1383 ("every act whatever of man that causes damage to another obliges him by whose fault it happened to repair it." LA. CIV. CODE arts. 2315, 2316).

72. CODE CIV. art. 1101 (trans. author) ("*Le contrat est une convention par laquelle une ou plusieur personnes s'obligent, envers une ou plusieurs autres, à donner, à faire ou à ne pas faire quelque chose*.")

legal capacity to contract, an object certain that forms the material purpose of the agreement, and a licit cause for the contract.[73]

The civilian concept of "cause," the last requirement, is broader than the common law concept of consideration. "Cause" is intertwined with the idea that promises are binding as a matter of fidelity and honesty, a concept dating back to Aristotle.[74] It is "the reason why a party obligates himself."[75] Cause includes not only the promise of an immediate or future economic benefit, but may also encompass a service or economic interest received in the past, or even a debtor's moral interest.[76]

Once formed, contracts have the force of law between the contracting parties and must be executed in good faith.[77] Breach of a contract will result in an obligation to pay interest (expectation) damages.[78] A contract must be interpreted according to the common intent of the contracting parties, without violating the literal terms of the contract.[79]

> With regard to the negotiation and formation of a contract, however, the Civil Code does not provide much guidance: The French Civil Code does not provide any rules as to the mechanism of negotiation and conclusion of contracts.
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> . . . .
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> The precontractual process is not subject to any specific forms and may be conducted freely, but the progression towards an agreement may start by a vague invitation to deal and end by an offer, which is defined as a proposal firm and precise enough to allow its beneficiary to form the

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73. CODE CIV. art. 1108 (trans. author) ("*Quatre conditions sont essentielles pour la validité d'une convention:*

Le consentement de la partie qui s'oblige;
Sa capacité de contracter;
Un objet certain qui forme la matière de l'engagement;
Une cause licite dans l'obligation.")

74. JAMES GORDLEY, THE PHILOSOPHICAL ORIGINS OF MODERN CONTRACT DOCTRINE 10-11 (1991).

75. LA. CIV. CODE art. 1967.

76. Joanna Schmidt-Szalewski, reporting for France in PRECONTRACTUAL LIABILITY: REPORTS TO THE XIIITH CONGRESS INTERNATIONAL ACADEMY OF COMPARATIVE LAW, Montreal, Canada, 18-24 August 1990, at 148-50 (Ewoud H. Hondius, ed., 1991) [hereinafter *France Report*].

77. CODE CIV. art 1134 (trans. author) ("*Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites. . . . Elles doivent être exécutées de bonne foi.")*

78. CODE CIV. art. 1142 (trans. author) ("*Toute obligation de faire ou de ne pas faire se résout en dommages et intérêts, en cas d'inexécution de la part du débiteur*.").

79. CODE CIV. art. 1156 (trans. author) ("*On doit dans les conventions rechercher quelle a été la commune intention des parties contractantes, plutôt que de s'arrêter au sens littéral des termes.").*

> contract by giving his acceptance. This would put an end to the precontractual process, by the formation of consent, which under French law is necessary, and, in principle, sufficient to the formation of a contract. . . .[80]

As described above, the civilian concept of contract focuses on the relationship between the parties, rather than on a declaration of intent or the creation of a bargain,[81] and the formation of a contract is not the dramatic event that it is in common law countries. As a result, courts in civil law jurisdictions are likely to find that parties are obligated to each other at an earlier stage of the negotiation process than courts in common law countries.[82]

1. *Culpa in Contrahendo*

When asked about precontractual liability and the duty of good faith and fair dealing in civilian jurisdictions, comparatists immediately refer to Jhering's concept of *culpa in contrahendo*.[83] *Culpa in contrahendo* provides that contracting parties are under a duty to negotiate in good faith, as measured by a negative standard.[84]

The impact and development of Jhering's *culpa in contrahendo* are easier to understand if one has some knowledge of the state of German law at the latter part of the nineteenth century. At that time, the German civil code was strictly and rigidly construed by the courts.[85] Jhering argued against this rigidity, reasoning that the only way to understand the law is to interpret it in light of the interests involved: laws were passed by

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80. Schmidt-Szalewski, *France Report, supra* note 76, at 154.

81. *See* Ben-Dror, *supra* note 16, at 193 (citing S. WILLISTON, CONTRACTS 20, 21 (Rev. ed. 1936) in describing the external declaration of the will as the basis for contractual duty).

82. Ralph B. Lake, *Letters of Intent: A Comparative Examination under English, U.S., French, and West German Law*, 18 GEO. WASH. J. INT'L L. & ECON. 331, 342 (1984); *see also* ANNE LAUDE, *LA RECONNAISSANCE PAR LE JUGE DE L'EXISTENCE D'UN CONTRAT* (1992).

83. *See, e.g.*, Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: a Comparative Study*, 77 HARV. L. REV. 401(1964). Under German law, the concept of good faith has grown from a general clause concerned with how to perform contracts (BGB § 242 provides that "the debtor is obliged to perform in such a manner as good faith requires, regard being paid to general practice.") into a "super control norm" for the whole civil code, as well as for large parts of German law outside the code. HORN/KOETZ/LESER, GERMAN PRIVATE AND COMMERCIAL LAW 135 (1982). The provisions in the U.C.C. dealing with good faith were inspired by the German Civil Code. E. Allen Farnsworth, *The Eason-Weinmann Colloquium on International and Comparative Law: Duties of Good Faith and Fair Dealing under the Unidroit Principles, Relevant International Conventions, and National Laws*, 3 TUL. J. INTL. & COMP. L. 47, 51 (1995).

84. *See* Kessler & Fine, *supra* note 83, at 402-03.

85. Mirmina, *supra* note 7, at 80.

individuals to protect the interests of individuals, the notions of justice and rights must permeate the legal system and be taken into account when applying the law.[86] This argument spearheaded a change in German law, allowing judges to interpret the German civil code with an eye towards equity and thus ensuring that the provisions of the code would not become outdated.[87]

Jhering developed the doctrine of *culpa in contrahendo* from Roman law sources in an effort to fill what he believed was a gap in German law.[88] His discussion contained two lines of thought which greatly influenced civilian legal systems: (1) liability for fault (*culpa*) in contracting, and (2) classification of damages into positive and negative damages.[89] Where a contract is rendered invalid or is prevented from being formed by the blameworthy act of one of the parties, the innocent party should not suffer damages because he relied on the validity of the contract.[90] The framers of the German Civil Code were influenced by Jhering's theory and developed elements of it into a general scheme of precontractual liability categorized under strict contractual fault but using the tort measure of damages as the standard for compensation and requiring reliance on the part of the innocent party.[91]

2. French Law

In contrast to its reception in Germany, Jhering's classification of *culpa in contrahendo* as a contract theory was rejected in France because

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86. *Id.* (discussing Rudolf von Jhering, *Der Zweck im Recht*, available in English as LAW AS A MEANS TO AN END (1877)).

87. Mirmina, *supra* note 7, at 79-80.

88. *Id.* at 81.

89. *Id.* at 145.

90. *Id.* at 79.

91. Ben-Dror, *supra* note 16, at 181; *see* § 307 BGB:

> Negative Interest. (1) If a person, in concluding a contract, the performance of which is impossible, knew or should have known that it was impossible, he is obliged to make compensation for any damage which the other party has sustained by relying upon the validity of the contract; not, however, beyond the value of the interest which the other party has in the validity of the contract. The duty to make compensation does not arise if the other party knew or should have known of the impossibility.

(As translated and quoted in Ben-Dror, *supra* note 16, at 181). *See also* § 242 BGB: "The debtor is obliged to perform in such a manner as good faith requires, regard being paid to general practice" translated in HORN/KOETZ/LESER, GERMAN PRIVATE AND COMMERCIAL LAW 135-45 (1982). While most of the United States should be categorized as common-law jurisdictions, Louisiana and Puerto Rico can best be described as mixed civilian jurisdictions, and both have acknowledged the concept of *culpa in contrahendo* to varying extents. *See infra* text accompanying notes 243-245.

it is perceived as being founded on the fictional premise that one can divine when a contract is in the making ("*Critiquant le caractére fictif et divinatoire de tel 'avant contrat,' les travaux plus récents refusent d'appliquer aux fautes précontractuelles les mécanismes de la responsabilité contractuelle"*).[92] In other words, French thought is that contract mechanisms are inappropriate in determining when precontractual bad faith exists because it is impossible to divine when a situation that does not result in a contract is "precontractual." However, the requirement of "*culpa*" or fault as a predicate to liability in a precontractual situation was accepted, as was the principle that misbehavior in the course of negotiations is actionable.[93]

The French concept of precontractual liability is not so much premised on a duty to negotiate in good faith as it is premised on a duty not to negotiate in bad faith—which brings us back to defining good faith by excluder analysis. Under French law, as long as no contract has been concluded, damages may be compensated only in tort as expressed by article 1382 of the Civil Code:[94] "Every act whatever of man that causes damage to another obliges him by whose fault it happened to repair it."[95] The operative word in this standard is "fault," and the definition of fault under French law brings an American attorney back to familiar ground: fault may defined as wrongful behavior which would not have been committed by a reasonably prudent man under the same circumstances;[96] it is not necessary for the plaintiff to show either an intentional or serious wrongdoing.[97] A reasonable man's behavior consists of loyal and good

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92. Schmidt, *La Sanction*, *infra* note 104, at 51.

93. *Id.*

94. Paris, Feb. 13, 1883: Gaz Pal. 1883, 414; Lyon, July 10, 1896: D. 1896, 2, 496; cass. Com. March 20, 1972: Bull. IV. n.93; J.C.P. 1973, 17543, note J. Schmidt; Rev. tr.dr.civ., 1972, p. 779, n.1, obs. Durry; cas. Com. Jan. 11 1984: Bull. IV. n.16.

95. C. CIV. art. 1382 ("*Tout fait quelconque de l'homme, qui cause à autrui un dommage, oblige celui par la faute duquel il est arrivé, à le réparer*" (Dalloz 1993-94)).

96. B. Starck, Droit civil. Obligations, T.1, *Responsabilité delictuelle*, by H. Roland et L. Boyer, 3d. ed. Litec, Paris, 1988, n.265, p. 150.; Joanna Schmidt-Szalewski, *France*, *in* FORMATION OF CONTRACTS AND PRECONTRACTUAL LIABILITY 86-95(1991). Note 23 of the Dalloz edition of the French Code Civil gives examples of fault leading to precontractual liability, citing Paris, 8 juill. 1972, J.C.P. 1973.ll. 17509, note Leloup; Rennes, 9 juill. 1975, D. 1976. 417, note Joanna Schmidt; Com. 3 oct. 1978, D. 1980. 55, note Schmidt-Szalewski; 25 fevr. 1986, Bul. Civ. Iv, n.33; Rev. trim. Dr. civ. 1987. 85, obs. Mestre, cassant; Paris 22 avr. 1983, Gaz. Pal. 1983. 1. 346, note Thr□ard; T. Com. Paris, 1er oct. 1985, Gaz. Pal. 1987.1.10, note Bonneau; Com. 5 Nov. 1991, Bull. Civ. iv, n.335.-Le Tourneau, D. 1987, Chron. 101.—Joanna Schmidt, Rev. trim. Dr. civ. 1974. 46.

97. *See* CODE CIV. art. 1383 "*Chacun est responsable du dommage qu'il a causé non seulement par son fait, mais encore par sa négligence ou par son imprudence*." (One is

faith negotiation; bad faith and lack of loyalty may therefore be labeled as precontractual wrongful behavior or "fault."[98]

In French usage, bad faith consists of any behavior that deceives the other party, including breach of negotiations when the other party reasonably expected the contract to be concluded;[99] refusal to renew a contract when the other party reasonably relied on a promise to renew;[100] disclosure of information the other party expected to be kept confidential;[101] and misinforming the other party about the elements of a negotiated contract (though misinformation is usually dealt with as fraud, rather than bad faith).[102]

In order for an act of precontractual bad faith to be actionable, however, the other classical tort requirements must be fulfilled: the compensable damage must have been caused by the bad act, the damage must be certain and it must be as yet uncompensated.[103] French jurists generally agree that an act of bad faith committed during precontractual negotiations gives rise to a cause of action in tort; however, that accord breaks down when it becomes a question of designating exactly when and how the principle is applicable.[104] The determination of that point hinges to some extent on the presence of reasonable reliance.[105]

French law bases its duty of good faith on the general tort principle that one is obligated to repair damage caused by one's act or failure to act. American law does not recognize a precontractual duty of good faith. Nevertheless, were American law to recognize such a duty, the analysis of what constitutes that duty would probably be very much the same as it is in France, and would be comparable to the standard duty of good faith, as set by American common law. A precontractual duty of good faith would be measured more by its absence than its presence, and a breach of that duty could be viewed as occurring where negotiations have proceeded to

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responsible not only for damage caused by ones' acts, but also for damage caused by ones negligence or imprudence." [trans. author]).

98. Schmidt, *France Report*, s*upra* note 76, at 150.

99. Cass. Com. March 20, 1972, prec, cited in FORMATION, *supra* note 96, at 96.

100. Cass. Com. Feb. 9, 1981, (cited in FORMATION, *supra* note 96, at 96).

101. Cass. Com., Oct. 3, 1978: D.1980, p. 55 note J. Schmidt (cited in FORMATION, *supra* note 96, at 96).

102. Schmidt-Szalewski, FORMATION, *supra* note 96, at 96.

103. *See id.*

104. Joanna Schmidt, *La Sanction de la Faute Précontractuelle*, 73 REVUE TRIMESTRIELLLE DE DROIT CIVIL 46, 51(1974) (*Le fait de l'un des partenaires empêchant la conclusion peut-il, alors, recevoir sanction? Une réponse affirmative est, généralement, retenue, mais l'accord se rompt lorsqu'il s'agit de désigner la technique applicable").*

105. *See id.*

the point where a party's pursuit of an opportunity it should have regarded as foregone constitutes an abuse of its discretion, given the context of the negotiations. This is very similar to the French concept that precontractual bad faith occurs when one party's fault causes damage to the other party and that act would not have been committed by a reasonably prudent man under the same circumstances. Both are objective standards, and both consider the context of the negotiations.

A judge's major concern is to render justice to the parties before her court and to do so through the use of well-structured legal reasoning.[106] The absence of a precontractual duty of good faith in American law makes the job more difficult because there is no theory that provides a straight-forward standard of behavior.[107] Instead, precontractual misbehavior must be remedied through less direct theories like promissory estoppel, and it remains for a later part of this Article to analyze the effectiveness of such theories, though it has been argued that they are adequate.[108]

III. WHEN THE DUTY OF GOOD FAITH ARISES

A. The Process of Contracting

As mentioned above, the imposition of any duty of good faith must depend on the context and extent of the dealings between the parties. Behavior that is not particularly harmful as between strangers can cause egregious harm in the context of extended negotiations: Borden's charging for rental and supplies might be expected had DeMusz been a stranger, but was unjustified given the history of the dealings between the parties. The same applies in a precontractual setting. Determining when precontractual liability should arise requires a balance between the freedom from contract and the duty of good faith—imposing too strict a standard of good faith will interfere with the freedom from contract.

According to classical theory, agreement is made and a contract is formed at the instant when an offer meets with an acceptance.[109] This model corresponds to situations where contracts come into existence

106. Knapp, *supra* note 9, at 715.

107. *See id*.

108. *See* text accompanying notes 174-223. *But see* Farnsworth, *supra* note 14, at 285-87 ("The negotiation of deals does not fit into the mold of offer and acceptance, but that does not mean that basic principles of contract law are inadequate to protect the rights of parties if their negotiations fail." Fair resolution of disputes arising out of failed negotiations can be reached through restitution, misrepresentation, or promissory estoppel.).

109. Schmidt, *La Sanction, supra* note 104, at 47.

without much preliminary negotiation.[110] However, agreement is not often given at a single, sudden moment in time. Commonly, an agreement is reached in a piecemeal fashion after several rounds with a succession of drafts.[111] The following description of this process reflects the American concern with arms-length dealing, freedom from contract, and the intent to be bound:

> There may first be an exchange of information and an identification of the parties' interests and differences, then a series of compromises with tentative agreement on major points, and finally a refining of contract terms. The negotiations may begin with managers, who refrain from making offers because they want the terms of any binding commitment to be worked out by their lawyers. Once these original negotiators decide that they have settled those matters that they regard as important, they turn the thing over to their lawyers. The drafts prepared by the lawyers are not offers because the lawyers lack authority to make offers. When the ultimate agreement is reached, it is often expected that it will be embodied in a document or documents that will be exchanged by the parties at a closing.[112]

A French scholar has similarly described the process as an escalating series of agreements.[113] Nevertheless, under both regimes, parties may be held to a duty of good faith on the basis of a preliminary agreement, a letter of intent, or other such document issued and agreed to by both parties in the course of such negotiations.

B. Preliminary Agreements and the Duty of Good Faith

"A gentlemen's agreement is an agreement which is not an agreement, made between two persons, neither of whom is a gentleman, whereby each expects the other to be strictly bound without himself being bound at all."[114] Having considered the role of the duty of good faith in French and American law, it is now time to focus on when in the course of negotiations such a duty arises—or should arise. Discussion will begin

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110. *Id.*

111. Farnsworth, *Precontractual Liability, supra* note 14, at 219; Richard Speidel, *Afterword: The Shifting Domain of Contract,* 90 NW. U. L. REV. 254, 256 (1995).

112. Farnsworth, *Precontractual Liability*, *supra* note 14, at 219.

113. Schmidt, *La Sanction, supra* note 104, at 47 ("*Le développement de la publicité et des moyens de communication avec pour conséquence l'augmentation du nombre des partenaires potentiels rend, pareillement, nécessaire une lente progression de l'accord contractuel vers sa formation définitive.*").

114. Attributed to Vaisey J. in an unreported interlocutory observation in Bloom v. Kinder, [1958] T.R. 91, quoted in D.K. Allen, England, in Precontractual Liability: Reports to the XIIIth Congress International Academy of Comparative Law 138 (1990).

with those situations where the parties have memorialized their negotiations in some sort of precontractual agreement, and will then move on to situations in which no such document exists.

1. United States

In the United States, the extent to which precontractual documents are legally binding depends largely upon the intent of the parties.[115] Preliminary agreements can be classified into three general types: (1) an agreement to engage in a transaction, (2) an agreement with open terms intended to be binding, and (3) a letter of intent.[116]

While an agreement to engage in a transaction may set out specific substantive terms of the deal, the parties do not intend to be bound by these terms, and undertake instead to continue the process of negotiation.[117] As the agreement to engage in a transaction, or "agreement to agree," is intended merely to create moral obligations or to record preliminary proposals and accords that could otherwise easily be forgotten in complex transactions, it is traditionally not binding at common law.[118] The parties negotiate with the knowledge that if they fail to reach ultimate agreement they will not be bound.[119] In that case, as there was no agreement, so there would be no possibility of a claim for lost expectations.[120] Bad faith would be actionable only under the traditional rubric of torts, not the contractual duty of good faith.

At the other extreme is an agreement with open terms. In this agreement, the parties have set out most of the terms of the deal, and they

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115. *See* JOSEPH M. PERILLO, 1 CORBIN ON CONTRACTS: FORMATION OF CONTRACTS § 2.8 (1996) (One of the most difficult and important areas of contract formation involves two interrelated issues: intent to be bound and definiteness of terms. Sometimes the cases confuse the two issues at times because indefiniteness of terms bears upon the solution of both questions. Indefiniteness may show a lack of finality, a lack of intention to be bound. Even if an intention to be bound is manifested by both parties, too much indefiniteness may invalidate the agreement, because of the difficulty in administering it. On the other hand, the parties may have satisfied the definiteness requirement but have manifested an intent not to be bound until a final integrated writing is drawn up, signed and delivered.).

116. Farnsworth, *Precontractual Liability, supra* note 14, at 250.

117. *Id.*

118. Lake, *supra* note 82, at 333-34; s*ee also* PERILLO, 1 CORBIN ON CONTRACTS, *supra* note 115, § 2.8(b). As a member of the House of Lords impatiently explained: "An agreement to enter into an agreement upon terms to be afterwards settled between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of that agreement are settled." Ridgway v. Wharton, 10 Eng. Rep. 1287, 1313 (H.L. 1857) (Lord Wensleydale) (quoted in Farnsworth, *Precontractual Liability, supra* note 14, at 264). Compare *supra* text accompanying notes 92-94 (French rejection of *culpa in contrahendo*).

119. Farnsworth, *Precontractual Liability, supra* note 14, at 263.

120. *Id.*

have agreed to be bound by these terms. However, they intend to continue negotiating the remaining terms. In these situations, the traditional "agreement to agree" rule barring enforcement has been considerably modified.[121] To some extent, that modification was seeded by the U.C.C. which provides that, with regard to a sales contract, not all terms must be stated as long as the contract is sufficient to show agreement, the parties have intended to make a contract, and there is a reasonably certain basis for giving an appropriate remedy.[122] If, despite continued negotiation by both parties, no agreement is reached on those open terms, a court may hold the parties bound by their original agreement and will supply necessary terms to the extent possible under the circumstances.[123] The concept has been expanded to apply to contracts beyond the scope of U.C.C. sales, and now the key factor determining whether such an agreement is enforceable is not the absence of normal contractual terms, but rather the intent of the parties.[124] If the parties intended to be bound, an agreement with open terms is a contract in all but name. The parties consider themselves bound, and consider that the drafting of a final contract will be a mere formality.

A consequence of an agreement with open terms is that, because it is itself a contract, it imposes a general obligation of fair dealing in the negotiation of the open terms.[125] "[P]arties can bind themselves to a concededly incomplete agreement . . . in the sense that they accept a mutual commitment to negotiate together in good faith in an effort to reach final agreement within the scope that has been settled in the preliminary agreement."[126] Where there is a bad faith failure to agree, and the parties intended to be bound by the agreed-upon terms of their agreement with open terms, then a court is likely to fill in the necessary terms if reasonable to do so, or impose other contract remedies.

Pennzoil Co. v. Texaco, Inc.[127] is probably the most well-known case involving an agreement with open terms, though in this case the

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121. Knapp, *supra* note 9, at 677.

122. U.C.C. § 2-204(3).

123. *Id*., official comment.

124. *See* Farnsworth, *Precontractual Liability*, *supra* note 14, at 253.

125. *Id.*

126. Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 71 (1989) (citation omitted); *see also* Teachers Ins. & Annuity Ass'n. v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986); Goodstein Constr. Corp. v. City of New York, 67 N.Y.2d 990, 494 N.E.2d 99, 502 N.Y.S.2d 994 (1986).

127. Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768 (Tex. Ct. App.); 481 U.S. 1 (1987) (holding that federal courts had no subject matter jurisdiction over what was a state law issue and dismissing the case from federal review).

document at issue was termed an "agreement in principle." Pennzoil, looking to purchase additional oil reserves, negotiated with the Getty Oil Company and its major stockholders, and reached an "agreement in principle" whereby Pennzoil was to purchase a substantial portion of Getty's shares for $110 per share. When Texaco subsequently agreed to pay $128 per share of Getty stock, thus pre-empting the Pennzoil "agreement," Pennzoil sued Texaco for tortious interference with contractual relations.[128] Obviously, a predicate to this suit was the existence of an enforceable contract between Getty and Pennzoil, and the trial court found that the essential terms were agreed-upon and the parties intended to be bound.[129] In other words, the jury found that based on the document at issue plus the behavior of the parties, the intent was to create a contract despite the limiting language contained in the "agreement in principle." Pennzoil was awarded $7.53 billion in actual damages and $1 billion in exemplary damages, causing Texaco to file for reorganization.[130]

The state appeals court considered several factors in determining whether the parties intended to be bound only by a formal, signed writing: (1) whether a party expressly reserved the right to be bound only when a written agreement is signed; (2) whether there was any partial performance by one party that the party disclaiming the contract accepted; (3) whether all essential terms of the alleged contract had been agreed upon; and (4) whether the complexity or magnitude of the transaction was such that a formal, executed writing would normally be expected.[131] The Texas Court of Appeals affirmed the jury's finding that the "agreement in principle" was a binding contract.[132]

The letter of intent is a third kind of preliminary agreement somewhere between an agreement with open terms and an agreement to engage in a transaction. A letter of intent may be legally binding in the United States, though jurisprudence is split. Generally, the intent of the parties at the time of the execution of the precontractual agreement is

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128. *Id*., 481 U.S. at 6-8.

129. *Texaco*, 728 S.W.2d at 790-96.

130. *Pennzoil*, 481 U.S. at 7 n.5, 107 S. Ct. at 1523 n.5 (the punitive portion of the damage award was lowered on appeal to $1 billion). Apparently while the write of certiorari was pending, the parties reached a settlement in the bankruptcy process whereby Pennzoil would receive $3 billion in cash. WALL STREET JOURNAL, 29 Jan. 1988, at 3. *See* Daniel C. Turack, [Precontractual Liability in] The United States in PRECONTRACTUAL LIABILITY: REPORTS TO THE XIIITH CONGRESS, INTERNATIONAL ACADEMY OF COMPARATIVE LAW 333, 335-36 & n.4 (1991) for discussion of the case and commentary.

131. *Id*. at 788-89.

132. *Texaco*, 729 S.W.2d at 790-92.

controlling and if the intent of the parties is clear from the language of the letter, a court will enforce the parties' wishes:[133]

> The courts are quite agreed upon general principles. The parties have power to contract as they please. They can bind themselves orally or by informal letters or telegrams if they like. On the other hand, they can maintain complete immunity from all obligation, even though they have expressed agreement orally or informally upon every detail of a complex transaction. The matter is merely one of expressed intention.[134]

As with an agreement to agree, if a letter of intent states explicitly that it is not binding and is expressly conditioned upon entrance into a mutually satisfactory definitive written agreement, then it will be found to be unenforceable.[135] Where this is the case, remedy for misbehavior will not lie in the contractual duty of good faith, though other theories may be available.

If a letter of intent is ambiguous, however, the decision whether the parties intended to enter a contract must be based upon an evaluation of the circumstances surrounding the parties' discussions, and deciding whether the parties intended to be bound may amount to a difficult question of fact, not law.[136] The mere use of the term "letter of intent" in a document does not mean *ipso facto* that the agreement is nonbinding, nor does the express statement that the parties intend to be bound to the duty to negotiate in good faith necessarily make the document binding.[137] At times, courts have held that an explicit "agreement to negotiate," that specifically adopts a duty of good faith cannot be enforced because there is no way to know what ultimate agreement, if any, would have resulted and no way to measure damages.[138] This reasoning is specious: the

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133. Lake, *supra* note 82, at 339; *see, e.g.*, Channel Home Centers v. Grossman, 795 F.2d 291, 292 (3d Cir. 1986) ("A property owner's promise to a prospective tenant, pursuant to a detailed letter of intent, to negotiate in good faith with the prospective tenant, and to withdraw the lease premises from the marketplace during the negotiation, can bind the owner for a reasonable period of time where the prospective tenant has expended significant sums of money in connection with the lease negotiations and preparation and where there was evidence that the letter of intent was of significant value to the property owner.").

134. Arnold Palmer Golf Company v. Fuqua Industries, Inc., 541 F.2d 584, 586 (6th Cir. 1976).

135. Terracom Development Group, Inc. v. Coleman Cable & Wire Co., 50 Ill. App. 3d 739, 365 N.E.2d 1028 (1977) (quoted in Lake, *supra* note 82, at 338).

136. *See Fuqua*, 541 F.2d at 588; Itek Corp. v. Chicago Aerial Industries (Itek I), 248 A.2d 625, 627-29 (Del. 1968).

137. Lake, *supra* note 82, at 338.

138. Farnsworth, *Precontractual Liability*, *supra* note 14, at 267 (citing Ridgeway Coal Co. v. FMC Corp., 616 F. Supp. 404, 407-08 (S.D.W. Va. 1985); Courtney & Fairbairn Ltd. v. Tolaini Bros., [1975] 1 W.L.R. 297, 301 (C.A. 1974) (Lord Denning)).

appropriate remedy would not be damages for the injured party's lost expectation under the prospective ultimate agreement but damages caused by the injured party's reliance on the agreement to negotiate.[139]

Nevertheless, in some cases the good faith clause contained in a preliminary agreement or "letter of intent" was held to be enforceable even though the anticipated final agreement was never realized. In *Itek Corp. v. Chicago Aerial Industries, Inc*., a letter agreement outlining the bare bones of a corporate acquisition provided that the parties "shall make every reasonable effort to agree upon and have prepared as quickly as possible a contract."[140] The Delaware Supreme Court found that summary judgment for the defendant was inappropriate because an issue of fact remained concerning whether the defendant's abrupt termination of negotiations upon receipt of a better offer from a third party was a breach of the agreement to exercise "every reasonable effort."[141] Thus, the court implicitly recognized that an agreement to negotiate could create a precontractual duty of good faith.[142]

Similarly, the Seventh Circuit Court of Appeals found that a preliminary memorandum stating that an "agreement in principle" to terms and conditions of a sales agreement was not a final agreement, but did require good faith negotiation: "Injecting new demands, such as an increase in price, late in the negotiating process can constitute bad faith in some circumstances."[143] Discussion of the duty of good faith in these cases, however, constitutes the exception rather than the rule, and bad faith behavior in such a situation will usually lead to damages under a theory of promissory estoppel, rather than a breach of the duty of good faith.[144]

Typically, such cases follow a pattern common in commercial life:

> Two firms reach concord on the general terms of their transaction. They sign a document, captioned "agreement in principle" or "letter of intent," memorializing these terms but anticipating further negotiations and decisions—an appraisal of the assets, the clearing of a title, the list is

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139. Farnsworth, *Precontractual Liability, supra* note 14, at 267.

140. 248 A.2d 625 (Del. 1968); *see also* Budget Marketing, Inc. v. Centronics Corp., 927 F.2d 421, 425 (8th Cir. 1991) (distinguishing from *Itek I*: no such duty where it is expressly disclaimed in the letter of intent).

141. A jury ultimately found for the defendant, 274 A.2d 141 (Del. 1971).

142. *See* PERILLO, 1 CORBIN ON CONTRACTS, *supra* note 115, § 2.8(b) (discussing *Itek I*).

143. Venture Assocs. Corp. v. Zenith Data Systems Corp., 987 F.2d 429 (7th Cir. 1993) (noted in PERILLO, 1 CORBIN ON CONTRACTS, *supra* note 115, § 2.8 (1997 Pocket part).

144. *See* Holmes, *supra* note 17, at 787-791 (promissory estoppel is increasingly resorted-to in letter-of-intent cases, and cases like *Itek* often involve acts of bad faith by the defending party).

> endless. One of these terms proves divisive, and the deal collapses. The party that perceives itself the loser then claims that the preliminary document has legal force independent of the definitive contract.[145]

In *Empro Manufacturing Co., Inc. v. Ball-Co Manufacturing, Inc.*, the "letter of intent" stated that the general terms and conditions of the proposal would be subject to and incorporated in a formal, definitive agreement, and that it would be subject to approval by the shareholders and board of directors of Empro.[146] Similarly, in *Skycom Corp. v. Telstar Corp*., the "agreement in principle" spoke of a "formal agreement" to follow, and gave defendant Telstar the option to back out if the parties could not come to agreement on refinancing.[147] Nevertheless, the "agreement in principle" listed a number of agreed-to terms. In determining whether the agreement was intended to be enforceable, the Seventh Circuit stated that "'intent' does not invite a tour through [the drafter's] cranium, with [the drafter] as the guide." What is required is an objective view of intent: "[t]he intent of the parties [to be bound] must necessarily be derived from a consideration of their words, written and oral, and their actions."[148] The Seventh Circuit found, in both cases, that the preliminary agreements were unenforceable.[149]

Thus in some cases limiting language contained in a letter of intent will prevent liability, while in other cases, a stipulated promise to negotiate in good faith will allow liability. Because of the possibility that a letter-of-intent's duty of good faith may be held to be binding, where parties intend that such a preliminary agreement remain merely a gentlemen's agreement, they must take care that their actions are consistent with that intent.[150]

If an American court attempts to enforce a precontractual duty of good faith as stipulated in a letter of intent, it is likely to define that duty narrowly. For example, in *Schwanbeck v. Federal-Mogul Corp.*,[151] the court examined the facts and circumstances surrounding a failed merger attempt in an effort to interpret a self-contradictory letter of intent. The

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145. *Empro Manufacturing Co., Inc.*, 870 F.2d 423, 424 (1989) (Easterbrook, Circuit Judge).

146. *Id*.

147. 813 F.2d 810, 813 (7th Cir. 1987).

148. *Id*. at 814.

149. *Skycom*, 813 F.2d at 816; *Empro*, 870 F.2d at 426.

150. *See generally* HEBERT BERNSTEIN & JOACHIM ZEKOLL, THE GENTLEMAN'S AGREEMENT IN LEGAL THEORY AND IN MODERN PRACTICE: *THE UNITED STATES* (forthcoming); Harris Ominsky, *Counseling the Client on "Gentleman's Agreements,"* 36 THE PRACTICAL LAWYER 25 (1990).

151. 31 Mass. App. Ct. 390, 578 N.E.2d 789 (Mass. Ct. App. 1991).

agreement provided 1) that "this letter is not intended to create, nor do you or we presently have any binding legal obligation whatever in any way relating to such sale and purchase . . ." and also (2) it is our intention, and, we understand, your intention immediately to proceed in good faith in the negotiation of . . . a binding definitive agreement." The court commented on this language, stating that "[t]o the degree this cordial language [discussing good faith] smoothed the hard edge of the 'this is not yet a binding deal' language that had preceded it, the letter soon . . . reverts to a 'keep-your-hands-on-your-wallet' tone."[152] Agreements like these, drafted presumably by attorneys devoted to the art of obfuscation, justifiably deserve to be characterized as "an invention of the devil."[153]

Although parties can agree to abide by a precontractual duty of good faith and a court may recognize such an agreement as potentially binding, as a practical matter, the court may find that the agreement to negotiate in good faith is amorphous and nebulous and the intent of the parties can only be fathomed by conjecture and surmise.[154] In an attempt to give effect to all the provisions of one such preliminary agreement, the court decided that, while the declared provision for the duty of good faith stood independent of the general disclaimer of binding effect, nevertheless the obligation to proceed in good faith meant something less than unremitting efforts to get to "yes," with the players at all times playing their cards face up: "[r]ather, the obligation means that the preliminary agreement has not been entered into for some ulterior purpose, such as to set up the proposed buyer from the outset as a stalking horse for another buyer, or to satisfy a creditor that steps to transform an asset into cash are actually under way."[155] Thus, if a preliminary agreement contains an obligation to proceed in good faith, and the parties to the agreement intend to be bound to that duty but nevertheless muddle their intent with contradictory indicators, the scope of that obligation may be limited to a standard of honesty in fact.

If parties undertake to negotiate in good faith, but make no other enforceable agreement, American courts typically are concerned with the preservation of the freedom from contract, finding it difficult to express

152. *Schwanbeck,* 31 Mass. App. Ct. at 393.

153. Quake Construction, Inc. v. American Airlines, Inc., 141 Ill. 2d 281, 152 Ill. Dec. 308, 565 N.E.2d 990, 1009 (1990).

154. *Schwanbeck*, 31 Mass. App. Ct. At 395.

155. *Id.* at 398.

what conduct or motives would constitute a breach of that obligation.[156] As the Seventh Circuit Court of Appeals expressed it:

> Good faith is no guide. In a business transaction both sides presumably try to get the best of the deal. That is the essence of bargaining in the free market. And in the context of this case, no legal rule bounds the run of business interest. So one cannot characterize self-interest as bad faith. No particular demand in negotiations could be termed dishonest, even if it seemed outrageous to the other party. The proper recourse is to walk away from the bargaining table, not to sue for bad faith negotiations.[157]

The definition of good faith as required by a preliminary agreement should be no more difficult than defining the implied covenant of good faith inherent in a full-grown contract. As stated earlier, good faith is most easily defined by analyzing its absence, and a breach of good faith may be viewed as occurring where negotiations have proceeded to the point that a party's pursuit of an opportunity it should have regarded as foregone constitutes an abuse of its discretion, as measured by the conduct of a reasonably prudent person and given the context of the negotiations. In *Texaco*, as in *Sons of Thunder*, Getty's negotiations with Texaco had proceeded to the point where its courting of Pennzoil was an abuse of discretion, given the context of the dealings between Pennzoil and Getty. On the other hand, when parties put a great deal of limiting language into a preliminary agreement, as in *Schwanbeck*, it seems implicit that the parties should not assume that their letter of intent is an agreement to forego the search for a better deal. In this case, only the severest "stalking horse" type of dishonesty could be considered an act of bad faith. It would also be unlikely that the alleged aggrieved party could prove that his reliance on a *Schwanbeck*-like letter of intent was reasonable.

2. French Law

Like American courts, French courts will not enforce precontractual instruments that expressly contemplate a subsequent formal contract.[158] However, French law differs substantially from American common law when a precontractual instrument is ambiguous about its intended effect.[159] In general, because French law is dominated by the idea that

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156. PERILLO, 1 CORBIN ON CONTRACTS, *supra* note 115, § 2.8.

157. Feldman v. Allegheny International, Inc., 850 F.2d 1217 (7th Cir. 1988).

158. Lake, *supra* note 82, at 342 (citing 2 R. SCHLESINGER, FORMATION OF CONTRACTS: A STUDY OF THE COMMON CORE OF LEGAL SYSTEMS 1650-52 (1968)).

159. *Id.*

consent is necessary and sufficient to make a contract, and French courts are not as demanding as to the proof of existence of a contract, precontractual agreements are given the status of a contract whenever there is proof of an agreement relating to a precise obligation.[160] Because "cause" embraces any advantage including the possibility of conclusion of a definitive contract, a mere promise to negotiate a contract is binding under French contract law if the agreement is written in terms clear enough to evidence an intent to be bound by a precise obligation.[161]

As with American law, French precontractual instruments can be placed in different categories. In contrast to the American categorizations discussed above, however, the French divisions are according to the types of obligations created, not the likelihood of enforceability. The most powerful such instrument is the *contrat de promesse*, or contract of undertaking, used primarily in real estate and credit transactions and creating on one or all parties the obligation to conclude a specified contract under specified terms.[162] A *contrat de promesse* is fully enforceable because all necessary terms have been agreed-upon. It is promissory only in that the completed contract will come into existence at some time in the future and is therefore subject to a suspensive condition.[163] Similarly, an *accord-cadre* or *contrat-cadre* is an agreement to contract on determined terms and is often used in supply contracts.[164] A *pacte de préférence* or right of first refusal is an agreement merely to prefer the beneficiary of the agreement over other potential contracting parties, and is enforceable as it is in the United States.[165] An *accord de principe* (agreement in principle) creates no obligation to contract, but only an obligation to negotiate.[166] Regardless of the form of a precontractual instrument, if it involves an agreement that gives rise to specific obligations, those obligations are enforceable under French law, and breach is sanctionable using classical mechanisms of contractual liability.[167] The only difficult and delicate task is in identifying the contract and defining exactly what obligations it creates.[168]

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160. Schmidt, *France Report*, *supra* note 76, at 153.
161. *Id.* at 154.
162. Schmidt, *La Sanction, supra* note 104, at 48.
163. *See id.*
164. *Id.* at 49.
165. *Id.*
166. *Id.*
167. *Id.* "*Les règles ordinaires du droit des contrats se développent; crées, les obligations doivent être respectées, leur inéxecution étant sanctionnée par les mechanismes classiques de la responsabilité civile contractuelle.*"
168. *Id.*

As in the United States, in France the scope of the duty of good faith in the context of a preliminary agreement depends on the nature of that agreement. If the agreement contains specific obligations, then the contractual duty of good faith is attendant to the performance of those obligations. American law may be more hesitant to find that a preliminary agreement is intended to be enforceable, because enforceability is predicated more on objective intent than agreement. But where both French and American law would find that a preliminary agreement is enforceable, then the duty of good faith is implicit in the performance of the obligations created by the agreement. Rather than hinging the enforceability of a duty of good faith on the determination of whether the parties meant a preliminary agreement to be enforceable *in toto* as American courts sometimes do, the French approach of beginning by determining the nature of an explicitly assumed duty is a more sensible way of determining whether one of the parties tried to recapture an opportunity it should have regarded as foregone.

Where there is no contract and no preliminary agreement, or where a preliminary agreement is unenforceable, both American and French law resort to non-contract theories in order to determine whether a negotiating party's behavior is sanctionable. Because there is a greater likelihood that a preliminary agreement will be found to be unenforceable in the United States, there is a greater possibility that such non-contract theories will be resorted-to by American plaintiffs seeking remedy for damages sustained when negotiations fail.

In the United States, when a plaintiff doubts that a preliminary agreement's stipulated duty of good faith is enforceable in contract, he typically pleads promissory estoppel in the alternative.[169] For example, in *Arcadian Phosphates, Inc., v. Arcadian Corp*., the potential buyer of a fertilizer company first argued that in withdrawing from negotiations, the seller had breached the contractual duty of good faith that had been agreed upon in a four-page memorandum.[170] The trial court found, and the reviewing court agreed, that the memorandum was not intended to be an enforceable contract.[171] Even though the parties had agreed in the memorandum "to cooperate fully and work judiciously" in order to

169. Other theories used to argue precontractual bad faith include equitable estoppel, misrepresentation, and tortious interference with precontractual negotiations, but promissory estoppel is by far the most commonly used sword, and is therefore the only one considered in this Article.

170. 884 F.2d 69 (2nd Cir. 1989).

171. *Arcadian Phosphates,* 884 F.2d at 70-71.

expedite the sale, the memorandum was not binding because it was subject to approval by both boards, it stipulated that assets would be valued at a "mutually agreeable market value" and it further stipulated that other terms would be "subject to mutual agreement."[172] The reviewing court then affirmed the dismissal of the breach of contract claim, but reversed on the plaintiff's alternate theory of promissory estoppel.[173]

C. Duty of Good Faith in the Absence of any Preliminary Agreement

1. American Law: Promissory Estoppel

In the absence of any sort of binding agreement, precontractual liability in the United States is most commonly predicated on the theory of promissory estoppel. The most relied-upon statement of this concept is that provided by the Restatement (Second) of Contracts § 90:

> (1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.[174]

The origins of estoppel lie in both the common law action of assumpsit and early equity decisions.[175] In the United States, the concept of promissory estoppel developed in four stages, and various states' interpretations of the concept generally remain along these four developmental divisions.[176]

In the first, or "estoppel" stage, the concept is limited to situations in which an existent contract is void for statute of frauds or statute of limitations reasons. For example, North Carolina declares that it does not adopt promissory estoppel as an affirmative cause of action, but it

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172. *Id.*

173. *Id.*, 884 F.2d at 74.

174. RESTATEMENT (SECOND) OF CONTRACTS § 90.

175. ERIC MILLS HOLMES, 3 CORBIN ON CONTRACTS § 8.11, at 39 (1996).

176. *Id.* § 8.12. *But see id.* § 8.12 at 149-53. (New York's interpretation of the concept has been described as a "wilderness" requiring the proof of five elements: (1) a "clear and unambiguous" promise, (2) a reasonable and foreseeable reliance by promisee or third party, (3) plaintiff's reliance was "unequivocally referable" to the promise [but it is unclear if this additional requirement must always be proven or proven only when the statute of frauds is in issue], (4) an injury sustained by the party asserting the estoppel, and the injury, in cases involving the Statute of Frauds, is elevated to the requirement of an unconscionable injury; and (5) enforcement is necessary to avoid injustice).

nevertheless embraces it as a refuge from the statute of frauds.[177] The second stage focuses on the concept of a contract, regarding reliance as a substitution for consideration. In jurisdictions adopting this interpretation, the focal point of examination is the nature of the promise, which judges sometimes require to be equivalent to an offer capable of being accepted.[178] In the third or "tort" stage of promissory estoppel, courts focus on the reliance component, analyzing whether reliance was both reasonable and foreseeable.[179] The fourth and most current interpretation is that described by section 90 of the Restatement of Contracts as a theory of equity.[180] Thus, there remains disagreement in the United States as to whether promissory estoppel is a theory grounded in contract, tort, or equity.[181]

The concept originally was very limited in scope, but has now expanded to an affirmative cause of action "felicitously following the principles of good faith, conscience and equity."[182] In the last two decades, the doctrine of promissory estoppel as expressed in the Restatement has developed beyond the failed-contract or tort theories of stage one and into one predicated on the equitable mandate to rectify wrongs with discretely designed corrective relief.[183] This has been

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177. *See, e.g.*, Joyner v. Massey, 97 N.C. 148, 1 S.E. 702 (1887); One North McDowell Ass'n. of Unit Owners, Inc. v. McDowell Dev. Co., 98 N.C. App. 125, 389 S.E. 834 (1990), *rev. denied* 327 N.C. 432, 3995 S.E.2d 686 (cited in 3 CORBIN, *supra* note 140, at 46 n.32).

178. *See* 3 CORBIN, *supra* note 175, § 8.11, pp. 52-53.

179. *Id*.

180. *See* discussion *infra* text accompanying notes 207-221.

181. Some of the commentary discussion the nature and expansion of promissory estoppel includes: Edward Yorio & Steve Thel, *The Promissory Basis of Section* 90, 101 YALE L. J. 111 (1991); William Lloyd Prosser, *The Borderland of Tort and Contract*, SELECTED TOPICS ON THE LAW OF TORTS 380 (1953); Douglas Kn. Newell, *Will Kindness Kill Contract?*, 24 HOFSTRA L. REV. 455 (1995); Charles L. Knapp, *Reliance in the Revised* Restatement*: The Proliferation of Promissory Estoppel*, 81 COLUMBIA L. REV. 52 (1981); Eric Mills Holmes, *Restatement of Promissory Estoppel*, 32 WILLAMETTE L. REV. 263 (1996); James Gordley, *Enforcing Promises*, 83 CALIF. L. REV. 547 (1995); Jay M. Feinman, *The Last Promissory Estoppel Article*, 61 FORDHAM L. REV. 303 (1992); Phuong N. Pham, *The Waning of Promissory Estoppel*, 79 CORNELL L. REV. 1263 (1994); Daniel A. Farber & John H. Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake*,*"* 52 U. CHI. L. REV. 903 (1985).

182. 3 CORBIN, *supra* note 175, § 8.11 pp. 52-53.

183. *Id.* § 8.11, p 55; *see also A/S Apothekeres Laboratorium for Specialpraeparater v. I.M.C. Chemical Group, Inc.*, 725 F.2d 1140, 1142 (7th Cir. 1984) (citations omitted).

> Traditional contract law, with its many formal requirements such as that of consideration, seemed too confining, so a doctrine of promissory estoppel was added to the law, which permits a party to be held to his promise in some circumstances even if it was not supported by consideration. But the remedies of contract law still seemed too confining (for example, punitive damages were unobtainable in a contract action); so the law strained to find tortious misconduct in [a] contract setting. The doctrine of equitable estoppel, a tort doctrine but one very similar to promissory estoppel was

described as perhaps "the most radical and expansive development of this century in the law of promissory liability."[184] Like two other grand principles articulated in the U.C.C. and adopted by the drafters of the Restatement, good faith and unconscionability, promissory estoppel states a principle of abstract justice capable of application in an infinite variety of factual situations.[185]

Section 90 of the Restatement is predicated on the demonstration of three elements: (1) a clear and unambiguous promise or agreement, (2) a reasonable and foreseeable reliance on that promise, and (3) a finding that justice requires enforcement of the promise (in other words, requiring proof of damage, causation, and equity).[186] The nature of each of these elements will be discussed with an eye to testing whether their absence or presence is consistent or inconsistent with a hypothetical precontractual duty of good faith.

While the doctrine of promissory estoppel has been expanded to an affirmative cause of action, and this expansion has apparently generated a steep increase in § 90 claims,[187] a study of mid-1990s cases indicates that only 15.74% of such reported claims survived an opposing motion, and 8.01% won on the merits.[188] This low success rate may indicate a judicial souring on the claim. Although the low success rate is consistent with United States courts' reluctance to interfere in the contracting process,[189] it

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> invented, even though the tort doctrine of deceit (fraud), which itself had expanded to reach negligent misrepresentations, covered much of the same ground . . . and therefore itself overlapped the contract doctrine of promissory estoppel.

184. Knapp, *supra* note 181, at 53.

185. *Id*. at 78. For example, a Westlaw search using the terms Restatement +1 (Second 2nd) +2 Contracts w/2 90 & Da (Aft 1985) gives a cite list of 179 federal court decisions dealing with promissory estoppel. The same query addressed to the ALLSTATE database gives an even larger list. *See also* Sidney W. DeLong, *The New Requirement of Enforcement Reliance in Commercial Promissory Estoppel: Section 90 as Catch-22*, 1997 WIS. L. REV. 943, 971 (966 promissory estoppel cases reported in Lexis for 1995-1996).

186. *See, e.g.*, *Arcadian Phosphates*, 884 F.2d at 74; Davis v. Davis, 855 P.2d 342, 348 (Wy. 1993); Dallum v. Farmers Union Central Exchange, Inc., 462 N.W.2d 608, 611 (Minn. App. 1990); *see also* Phuong N. Pham, *The Waning of Promissory Estoppel*, 79 CORNELL L. REV. 1263, 1280-83 (1994) ("While Section 90 does not expressly require that injury result from the promisee's reliance, nevertheless, courts and scholars often regard resultant injury as an essential element." Additionally, a number of cases rejecting promissory estoppel claims on reliance grounds suggest that the promisee must establish definite and substantial reliance by showing causation—but for the promise, she would not have so acted.). *But see* New York's expansion of the usual elements, discussed *supra* note 176.

187. *See supra* note 185.

188. *See* Robert A. Hillman, *Questioning the "New Consensus" on Promissory Estoppel: An Empirical and Theoretical Study*, 98 COLUM. L. REV. 580, 590 (1998); *see also* DeLong, *supra* note 185, at 973 (exceedingly small percentage of promissory estoppel cases are successful).

189. *See id.* at 596.

could also be caused by a judicial view of the doctrine's application as historically incoherent.[190] Additionally, the abstract call for "justice" in Section 90's third element may be encouraging plaintiffs with tenuous promissory estoppel claims to "throw [it] in" along with their contract or other claims.[191] This failure of promissory estoppel claims is leading to a call for reappraisal of the doctrine.[192]

Under the current formulation of § 90, in examining any particular precontractual situation to determine whether promissory estoppel should lie, a court first measures the nature and extent of the promise made. A promise is a "manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."[193] The promise must be examined because only a seriously considered promise can justify definite and substantial reliance.[194] While some courts find that the promise giving rise to the application of promissory estoppel need not be so definite with respect to all details that a contract would result if the promise were supported by consideration, other courts have held in precontractual situations that a promise or agreement must be clear, definite, and unambiguous as to essential terms.

In other words, given a precontractual situation, some courts seem to require that the promise at issue amount to an agreement with open terms before reliance on that promise will be justified.[195] The Supreme Court of North Dakota, in *Lohse v. Atlantic Richfield Co*., seemed to set just such a standard, stating that it would require a promise encompassing all essential terms.[196] Lohse and the defendant's agent had agreed upon royalty, bonus, and primary term in connection with a potential oil and gas lease.[197] The agreement was made orally, and no other terms were agreed upon. In view of the complexity required by such agreements, the court held that because the parties had failed to agree to, or even discuss, many essential terms of an oil and gas lease, a promise sufficient for promissory estoppel purposes had not been established.[198]

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190. *See id.* at 586 (discussing legal scholars' view of application as incoherent).
191. *Id.* at 596.
192. DeLong, *supra* note 185, at 945.
193. RESTATEMENT (SECOND) OF CONTRACTS § 2 (1981).
194. Yorio & Thel, *supra* note 181, at 113.
195. *See, e.g.*, Lohse v. Atlantic Richfield Co., 389 N.W.2d 352, 356 (N.D. 1986); Prenger v. Baumhoer, 939 S.W.2d 23, 26-28 (1997).
196. Lohse v. Atlantic Richfield Co., 389 N.W.2d 352, 356 (N.D. 1986).
197. *Id.*
198. *Id.* at 357.

In view of the fact that the oral promises given were vague and insubstantial, the court's statement that it would require an all-encompassing promise was unnecessarily broad. The court need only have stated that it was unreasonable to rely upon the limited terms agreed-upon, given the oil-and-gas context. The standard imposed by the court in rejecting Lohse's claim—that it would require a promise encompassing all essential terms—was in the nature of an anvil, when a fly-swatter would have sufficed. A promise will be more seriously given and more definite when parties have been negotiating for a long time in great detail. It will be less definite when, as in *Lohse*, their contacts are sporadic and casual.

In contrast to *Lohse*, Nebraska's Supreme Court used a lower standard for evaluating a promise in *Rosnick v. Dinsmore*. According to the Court, promissory estoppel "does not impose the requirement that the promise giving rise to the cause of action must be so comprehensive in scope as to meet the requirements of an offer that would ripen into a contract if accepted by the promisee."[199] In this case, the promisor promised to contribute $1 million to expand the promisee's business. In exchange, he was to be given an option on thirty percent of the business's stock. The promisor repeatedly assured the promisee that the money was forthcoming, and in fact forwarded some of the money. In reliance on those assurances, the promisee used his personal funds to support the company temporarily, trusting that the promisor would later reimburse him.[200] When the promisor subsequently refused to follow through, Rasnick's business failed.[201] The court rejected any requirement of "definiteness" in an action based upon promissory estoppel and held that the promise relied upon was not indefinite.[202] The court found that an action for promissory estoppel depends not on the nature of the promise, but on the nature of the reliance—the reliance must be reasonable and foreseeable.[203] The court then held that the reasonableness of the promisee's reliance was an issue for a jury to determine.[204]

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199. Rosnick v. Dinsmore, 235 Neb. 738, 749, 457 N.W.2d 793 (Neb. 1990).

200. *See id.* at 743-48.

201. *Id.*

202. *Id*. at 748.

203. *Id.*

204. Pappas Industrial Parks, Inc. v. Psarros, 24 Mass. App. Ct. 596, 599, 511 N.E.2d 621,623 (Mass. App. 1987); *see also* McWilliams v. American Med. Int'l, Inc., 960 F. Supp. 1547, 1572 (N.D. Ala. 1997) (finding it reasonable for the plaintiff retiree to rely on his former CEO's letter promising that he would still qualify for group medical insurance should he decide to take early retirement).

Turning to the reliance issues in promissory estoppel, reliance has been found to be unreasonable where the circumstances are such that a reasonable businessman would be aware that the negotiations were inchoate and that no presumed agreement could be relied upon.[205] Reliance is also unreasonable when the promise itself was unenforceable due to illegality.[206] As with the nature of the promise issue, reliance is more likely to be reasonable and foreseeable where parties have spent an extended time negotiating. It is more likely to be unreasonable where those negotiations are summary or shallow. Neither the nature of the promise nor the nature of the reliance really gives consistent guidelines on when an action for promissory estoppel lies.

The third and most important element of promissory estoppel, and the one that underlies all such decisions, is that equity demands that the promise be enforced. While the first two considerations involve questions of fact and balance, it is often stated that the third requirement involves a policy decision by the court and necessarily embraces an element of discretion.[207] The best known demonstration of the use of this element in a precontractual setting is undoubtedly *Hoffmann v. Red Owl Stores*.[208]

Mr. Hoffman, who owned and operated a bakery in Wautoma, Wisconsin, was interested in a franchise for a Red Owl grocery store. He approached Red Owl, and Red Owl repeatedly assured him that for $18,000, Red Owl would establish Hoffman in a store in Chilton, Wisconsin. As practical experience for running a franchised grocery store, Red Owl encouraged Hoffman to buy and manage a small grocery store in Wautoma, Wisconsin. Hoffman did so. A few months later, Red Owl advised Hoffman to sell the grocery, now operating at a profit. Hoffman again followed Red Owl's advice, taking a capital loss. After giving further assurances that $18,000 would be enough to get set up in the franchise, Red Owl agents encouraged Hoffman to purchase a site for the store in Chilton, and Hoffman made a down payment on a site. Red Owl then advised Hoffman to sell his bakery to raise capital for the franchise, saying "Everything is ready to go. Get your money together and we're set." Hoffman sold the bakery and obtained employment on

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205. Gibson v. RTC, 51 F.3d 1016, 1025 (1995).

206. Kiely v. Raytheon Co., 105 F.3d 734, 737 (1st Cir. 1997).

207. Hoffman v. Red Owl Stores, Inc., 26 Wis.2d 683, 698, 133 N.W.2d 267, 275 (Wis. 1965); Durkee v. Good Year Tire & Rubber Co., 676 F. Supp. 189, 190 (W.D. Wis. 1987); Inter-Mountain Threading, Inc. v. Baker Hughes Tubular Services, 812 P.2d 555, 560 (Wyo. 1991); U.S. Oil Co. v. Midwest Auto Care Services, 150 Wis.2d 80, 89, 44 N.W.2d 825, 828 (Wis. App 1989).

208. 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

the night shift at another bakery. When Red Owl's credit manager was finally consulted, he found that $18,000 would not be enough to finance the store, and the deal fell through. Mr. Hoffman brought suit and won on a theory of promissory estoppel.[209]

With regard to the first two elements of promissory estoppel, the court found that the defendants had given Hoffman a number of promises and assurances upon which Hoffman had relied and acted upon to his detriment.[210] The discussion then turned to the third element. As stated by the court, the third element of promissory estoppel requires that in addition to the necessary promise and reliance, the situation must be such that injustice can be avoided only by enforcement of the promise.[211] Phrased this way, the third element contains two components: first, that promissory estoppel be the only possible remedy (a standard requirement of equity theories), and second that it would be unjust not to enforce the promise.

With regard to the first component, the court stated that no other possible theory had been presented to, or discovered by, the court that would permit plaintiffs to recover because while an action for fraud and deceit would be comparable, it could not be predicated on unfulfilled promises. The court also found that there was no evidence that would support a finding that any of the promises were made "in bad faith"—i.e., dishonestly. Why then did the Wisconsin Supreme Court hold for Hoffman? Because the development of the law of promissory estoppel "is an attempt by the courts to keep remedies abreast of increased moral consciousness of honesty and fair representations in all business dealings."[212]

Restated, then, the Wisconsin Supreme Court's cryptic statement indicated that Red Owl was liable because it had culpably breached Hoffman's reasonable expectations that he would be able to buy a franchise for $18,000. Though Red Owl had not been dishonest, its actions had been unfair. The court's holding exemplified the first principle of Jhering's theory: the court found that the innocent Mr. Hoffman should not suffer for Red Owl's failure to complete the

209. *Id.* at 697.
210. *Id.*
211. *Id.* at 694.
212. *Id.* at 695; 133 N.W.2d at 273. *But see* Mohamed Yehia Mattar, *Promissory Estoppel: Common Law Wine in Civil Law Bottles*, 4 TU. CIV. L. FORUM 71, 113 (1988) (arguing that one of the differences between *culpa in contrahendo* and promissory estoppel is that the former presupposes fault, while misconduct is irrelevant to the question of reliance).

agreement.[213] The court rejected the U.C.C. § 1-201 "honesty-in-fact" standard and adopted an objective standard for the level of injustice necessary to enforce a promise.[214] This objective standard, based on "honest and fair representations in business dealings," is substantially equivalent to the definition of good faith discussed earlier. Red Owl was held liable because its actions demonstrated bad faith or fault. In demanding more money for the franchise than it had repeatedly assured Hoffman was necessary, Red Owl tried to recapture a foregone opportunity to set the price given the context of the parties' extended negotiations. Similarly, in demanding rental from THE JESSICA LORI for the clam shucking equipment, Borden tried to recapture a foregone opportunity given the context of the parties' agreements. While the language used in *Hoffman* differs from that used in *Sons of Thunder*, the concept is the same.[215]

Some commentators have found that, especially in a commercial context, the establishment of the third element of promissory estoppel is predicated on the need for trust. "Promissory estoppel developed to protect the ability of individual to trust promises in circumstances where trust is essential."[216]

> [T]rust is essential to our basic economic institutions, it is a public good. . . .
>
> Seen in this light, the cases in which courts have pushed the doctrine of promissory estoppel beyond its stated justification and technical limitations are characterized by a strong need both by the parties and society for a high

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213. *See* discussion of Jhering, *supra* text accompanying notes 90-98.

214. *But see* Randy E. Barnett & Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentations*, 15 HOFSTRA L. REV. 443, 490 & n.220 (1987) ("Although the [*Hoffman*] court imposed liability on the basis of promissory estoppel, it did not explain why liability was appropriate in the absence of either a contract or a tort. The court only noted that the plaintiffs had relied on the defendant's promise, and that whether liability was appropriate involved a discretionary policy decision by the court as to whether a remedy was needed to prevent injustice.").

215. The same analysis can be applied to the facts of *Cyberchron Corp. v. Calldata Systems Development, Inc*., 47 F.3d 39, 45 (2nd Cir. 1995). In *Cyberchron,* even under New York law, the Second Circuit affirmed the lower court's finding that promissory estoppel was appropriate because the injury that resulted from the relied-upon promise was unconscionable:

> Grumman's conduct exerting pressure on Cyberchron to produce the units at great expense, and then abruptly terminating the transaction to purchase heavier, inferior equipment at a later date from another company, was unconscionable. At the same time that Grumman was pressuring Cyberchron to produce, with the promise of payment, it was already negotiating with another company to do the work.

216. State Bank of Standish v. Curry, 442 Mich. 76, 84, 500 N.W.2d 104,107 (Mich. 1993) (citing Daniel A. Farber & John H. Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake,"* 52 U. CHI. L. REV. 903, 928, 942 (1985)).

> level of trust. They involve relationships in which one party must depend on the word of the other to engage in socially beneficial reliance. . . . The point in these cases is not that reliance has taken place in a particular instance, but rather that reliance should be encouraged among participants in a class of activities.[217]

If trust forms the basis of the entitlement to rely,[218] then the question must be when is a party entitled to rely on a promise because trust has become essential? And how is "essential trust" to be distinguished from injustice? At this point, the argument becomes like a children's story in which the spot of dirt—the nature of the third element of promissory estoppel—is never cleaned up or resolved but only moved from place to place.[219] Premising promissory estoppel on essential trust or avoiding injustice, without more guidance, requires a court to exercise its subjective opinion about when trust is essential or when an injustice will result. It does not set an objective standard, and thus properly evokes concerns about judicial paternalism.[220]

Additionally, premising precontractual liability on a breach of trust may actually hamper the formation of contracts in industries where trust and gentlemen's agreements predominate: negotiating parties will be hesitant to enter negotiations if they fear liability. The specter of legal liability might limit desired flexibility in inter-party dealings, and thereby discourage negotiation and trade.

In the application of promissory estoppel to precontractual situations, the determinative and normative element must be the third element requiring the exercise of judicial discretion to avoid injustice. Viewing the concept this way recognizes that the first two elements, a promise and a foreseeable reliance, are factual measures and not normative ones, despite scholarly discussions about whether the concept should be viewed as promise-focused or reliance-focused.[221] American

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217. Farber & Matheson, *supra* note 216, at 903, 928-29.

218. *State Bank*, 500 N.W.2d at 107.

219. *See e.g.* Dr. Seuss, THE CAT IN THE HAT COMES BACK (1958) (Trespassing cat moves "pink cat ring" from bathtub to a series of other locations before getting help with clean-up).

220. *See generally* Douglas K. Newell, *Will Kindness Kill Contract?*, 24 HOFSTRA L. REV. 455, 473 (1995) (arguing that while a relational view of the process of contracting is valuable, one should remember that the virtues of caring and kindness are part of society without being forced by law and when forced are no longer virtues).

221. *See* Yorio & Thel, *supra* note 181, at 115; Phuong N. Pham, *The Waning of Promissory Estoppel*, 79 CORNELL L. REV. 1263, 1268-70 (1994) (discussing the conflict between scholars who view promissory estoppel cases focused on the nature of the promise as demonstrating the survival of the aleatory view of contracts versus scholars who view "reliance" cases as demonstrating the death of contract law theory.).

courts typically avoid discussion of the third element, couching their rationale instead in terms of the nature of the promise or of the reliance, and thus failing to fully analyze their holdings, and failing to state simply and precisely why it is that liability is being imposed.[222]

The problem lies not with the courts, but with the doctrine. The doctrine of promissory estoppel is imprecise and conclusional: it states a conclusion but gives little guidance on when injustice must be avoided by the enforcement of the promise.[223] The proposed test encompasses all three elements of promissory estoppel—promise, reliance, and a resulting injustice—but gives a simpler and more precise way to state why liability is being imposed because it is premised on an objective standard of reasonable behavior. To reiterate that proposed standard, the duty of good faith in negotiation is breached where negotiations had proceeded to the point where a party's pursuit of an opportunity it should have regarded as foregone constitutes an abuse of its discretion, given the context of the negotiations. Thus, in *Red Owl*, negotiations had continued to the point where Red Owl should have regarded as foregone the opportunity to set a price for Mr. Hoffman's franchise any higher than $18,000.

2. French Law

a. Tortious Fault (France)

One of the main theories upon which American common law relies in a precontractual situation is promissory estoppel.[224] Underpinning the American rejection of a precontractual duty of good faith is a concern that the imposition of the duty will open the flood gates of litigation and thus interfere with the freedom from contract, as well as discourage the free creation of new agreements.[225] The same concern for the balance

222. Barnett & Becker, *supra* note 214, at 495.

223. At best, the guidance is circular, referring back to the nature of the promise ordinance. Comment b of § 90 directs the court to base its decision on

> the reasonableness of the promisee's reliance, on its definite and substantial character in relation to the remedy sought, on the formality with which the promise is made, on the extent to which the evidentiary, cautionary, deterrent and channeling functions of form are met by the commercial setting or otherwise, and on the extent to which such other policies as the enforcement of bargains and the prevention of unjust enrichment are relevant.

224. It must be emphasized, though, that promissory estoppel is not primarily a precontractual tool. It is usually applied in the context of an existing contract or, at minimum, a letter of intent.

225. *See* discussion of the importance of arms-length dealing in common law, *supra* text accompanying notes 14-16, 156-57. *See also* Newell, *supra* note 181 on the danger of over-emphasis of caring and kindness; Bernstein & Zekoll, *supra* note 150 on American

between the freedom from contract and maintaining some control over the fairness of the negotiation process is present in French law.

The preconditions for establishing tortious liability under Code civil article 1382 are similar to the elements of a common law tort. Instead of proving duty, breach, causation-in-fact, and damages, a plaintiff must establish fault, causation-in-fact, and compensable damages.[226] Fault can be compared to a combination of duty and breach.[227] In a precontractual situation, fault is not merely wrongful behavior that would not have been committed by a reasonable man under the same circumstances, that fault must also be obvious and indisputable: "it would amount to a serious injury towards individual freedom and business security if one could easily be liable for breach of negotiations and dealing with a competitor; the precontractual fault must, in other words, be obvious and indisputable."[228] In other words, the fault must be an act bad enough to overcome the party's interest in freedom from contract, though the bad act need not be intentional.[229] While professionals who deal with consumers are held to a higher standard,[230] in France, as in the United States, a mere rupture of negotiations will not by itself lead to liability.[231]

For example, in one case decided by the *chambre commerciale* of the *Cour de cassation* in 1972, the defendant distributor of American-made machines entered into negotiations with the plaintiff buyer.[232] After the plaintiff went to the United States to see the machines, he asked the defendant for certain information that would facilitate his choice. The defendant failed to reply and intentionally withheld an estimate prepared by the manufacturer. Two weeks later, the defendant signed a contract to supply a machine to one of the plaintiff's competitors, agreeing not to sell another machine in the same area for two years. The lower court found that there had been a wrongful breaking-off of negotiations and held the

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businessmen's concern that over-specificity in contracting will discourage the formation of working agreements.

226. *See* Schmidt-Szalewski, FORMATION OF CONTRACTS, *supra* note 96, at 95.

227. *See supra* text accompanying notes 96-98 (reasonable-man standard).

228. Pau, Jan. 14, 1969, D. 1969, at 716 (trans. Schmidt, FORMATION OF CONTRACTS, *supra* note 96, at 96), discussed also in NICHOLAS, *supra* note 3, at 71.

229. *See* Schmidt, *La Sanction*, *supra* note 104, at 52.

230. *See id.* at 54 (as here, a professional will be held to the standard of a reasonable professional under the circumstances—he will need to be more prudent with vulnerable consumers, but can hard-bargain with fellow professionals).

231. *See* Schmidt, *La Sanction, supra* note 104, at 52 ("*La rupture des pourparlers ne pourra, cependant, entrainer la mise en jeu de la responsabilité de son auteur que si elle peut être qualifiée de fautive.*" [trans. author]).

232. Com. 20.3.1972, JCP 1973.II.17543 (*cited and discussed in* NICHOLAS, *supra* note 3, at 70-71).

defendant liable in tort. The *Cour de cassation* upheld the decision because the defendant had deliberately withheld the estimate and kept the plaintiff in the dark, and then unilaterally and capriciously broke off the negotiations at an advanced stage in the knowledge that the plaintiff had incurred considerable expense. The court concluded that the defendant had "broken the rules of good faith in commercial relations."[233] Another way of stating this could have been that the negotiations had proceeded to the point where the distributor's pursuit of an opportunity to sell a machine to the competitor should have been regarded as foregone and constituted an abuse of its discretion, given the context of the negotiations.

According to French law, liability typically lies where one party enters into negotiations without having any intent to contract, yet creates a reasonable expectation in the other party that a contract will be forthcoming so that the other incurs substantial precontractual expenses.[234] Likewise, liability will lie if the negotiations are well advanced and one party breaks off negotiations out of pure caprice, in an arbitrary and unfair manner, as with the case just discussed.[235]

In order not to allow potential precontractual liability to act to the detriment of the principle of freedom from contract, the French limit the notion of the precontractual duty of good faith to those situations that demonstrate that the reliance generated by the acts (which includes the promises) of the at-fault party was serious, legitimate, and foreseeable.[236] The fault itself must be obvious and beyond dispute.[237] In other words, an act of precontractual bad faith is dependent on the interactions between the parties, the extent and foreseeability of the reliance, and the harm caused by the act given the context, as with the American concept of promissory estoppel.

In France as in the United States, the plaintiff must prove that the defendant's act or failure to act was the instrumentality of the damage.[238] While causation is not usually discussed in precontractual liability cases, it can upon occasion become important. For example, in one reported case, a borrower asked his bank at the time of the loan to arrange for repayment insurance. He did not learn that the insurance had been

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233. NICHOLAS, *supra* note 3, at 71.

234. *See id.* at 53.

235. *Id.*

236. JOANNA SCHMIDT, NEGOTIATION ET CONCLUSION DE CONTRATS 108, at 214 (1982)

237. NICHOLAS, *supra* note 3, at 71.

238. Civ.2e, 29 mars 1971, J.C.P. 1972. Ll 17086 (2e esp.,), note Boré (cited in Code Civ. Art. 1384 n.11 (Dalloz).

refused until he became handicapped and attempted to collect. On finding that he had no insurance, he brought suit against the bank. The lower court decided that the misinformation caused the borrower to incur the loan without insurance and therefore ordered the bank to act as insurer for the remaining reimbursement of the loan. On appeal, the bank's liability was reduced on the grounds that the misinformation did not cause the borrower to incur the loan contract, but only deprived him of "an important element of evaluation" of the conditions of the contract.[239] Furthermore, causation may be somewhat more complicated than first appears when a defendant argues that his breach of the negotiations was caused by the plaintiff's misbehavior. In such a case, both parties' conduct must be analyzed in order to determine causation, and if both parties' behavior caused the damage, then liability may be shared under a contributory negligence standard.[240] As with common law torts, unless there is damage, there can be no tort. The compensable damage must be certain and not yet compensated.[241] The French "*bon père de famille*" (anglicized as the reasonably prudent man) standard translates well when considering whether the pursuit of a opportunity is abusive and should have been considered foregone.[242] The French reasonable man standard also translates into the issues dealt with in promissory estoppel: the interactions between the parties (promises), reliance, and an unconscionable act that causes damage.

3. Mixed-Civilian Jurisdictions

While the United States consists primarily of common law states, it also contains two jurisdictions, Puerto Rico and Louisiana, whose law is best described as mixed-civilian,[243] and whose civilian heritage is constantly exposed to pressure to conform with common law.[244] With regard to fault and precontractual liability, both jurisdictions deal with and attempt to resolve the differences between *culpa in contrahendo* and promissory estoppel.

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239. Schmidt-Szalewski, *France Report*, *supra* note 76, at 151-52 (citing Rennes, 9 July 1975: D. 1976, at 417, note J. Schmidt).

240. Schmidt-Szalewski, FORMATION, *supra* note 96, at 96-97.

241. *Id*. at 95.

242. *Id*. *See also* Têtе, *supra* note 67, at 54, 32 LOY. L. REV. 54 (likening Louisiana's reasonable man standard to the French *bon père de famille* or prudent man standard).

243. 1974 Louisiana Comment, LA. REV. STAT. ANN § 10:1-103 (West 1994).

244. *See* Joachim Zekoll, *The Louisiana Private-Law System: The Best of Both Worlds*, 10 TUL. EUR. & CIV. L.F. 1, 3 (1995) (describing pressure on Louisiana).

Puerto Rico recognizes *culpa in contrahendo* as mandating a precontractual duty of good faith:[245] "an unjust withdrawal [or termination from] the pre-contractual phase [of negotiations] may result in extra-contractual liability under Article 1802 of the Civil Code."[246] As described by a United States district court faced with interpreting and applying this article,

> good faith imposes on the parties negotiating or attempting to negotiate, an archetype of social conduct, loyalty and fidelity to the word given . . . and consists in that every party to the contractual relation commits himself trustingly to the loyal conduct of the other party. Each confides in that the other will not defraud him. . . . The parties are under the obligation to conduct themselves according to good faith in the sense that each is burdened by a reciprocal loyalty to observe a conduct that is socially valuable and demandable.[247]

Given the context of the case—the federal court clearly found the *culpa-in-contrahendo* standard arcane—the standard as stated seems exaggerated and certainly inconsistent with the French concept, but it does show that Puerto Rico affirmatively recognizes a precontractual duty of good faith.[248]

Louisiana's mixed-civilian heritage began in the early nineteenth century, when one of the drafters of the Louisiana Civil Code, although using the language of the original projet Napoleon, listed Spanish and French sources as authority for the principles given in the Code.[249] When Louisiana was acquired from France by Thomas Jefferson in 1803, it had been owned by France for only one month (Nov. 30, 1803 to Dec. 20, 1803). From 1763 until 1803, Louisiana was a Spanish territory, but it had been owned by France prior to that time. With the Louisiana Purchase, English-speaking Americans started flooding into the

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245. 3 CORBIN § 8.12, *supra* note 175, at 177-78.

246. Satellite Broadcasting Cable v. Telefónica de España, No. 90-1662(PG) (*Satellite II*) (D.P.R. April 7, 1992) at 14 (*quoted in* Satellite Broadcasting Cable, Inc. v. Telefónica de España, 807 F. Supp. 218, 220 (1992)(*Satellite III*)).

247. Whirlpool Corporation v. U.M.C.O. Intl. Corp., 748 F. Supp 1557, 1562 (S.D. Fla. 1990).

248. While common law attorneys and scholars, as exemplified by the *Whirlpool* court, may find *culpa in contrahendo* "arcane," similarly, civilian scholars find the common law concept of consideration strange. *See* Zekoll, *supra* note 244, at 7 (quoting JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 284 (2d ed. 1991)).

249. L. MOREAU-LISLET, DIGEST OF THE CIVIL LAWS NOW IN FORCE IN THE TERRITORY OF ORLEANS (1972 reprint of 1804 original De La Vergne volume). Moreau-Lislet also translated into English those portions of a Spanish compilation of laws used in Louisiana, LAS SIETE PARTIDAS.

territory.[250] At first, President Thomas Jefferson desired legal uniformity and was committed to gradually replacing local law with common law, otherwise he believed the "cement of the union would not harden if it contained mixed legal systems."[251] As a first step, judges were chosen, and the writ of trial by jury was installed.[252] The resulting mixture of English, French, and Spanish legal systems was described as "a confusion worse than that of babel."[253] Spanish law was portrayed as barbaric and bizarre by common law advocates, and native French and Spanish Louisianians regarded common law as "a veritable *grimoire*" (a book of magic or an unintelligible scrawl).[254] The "*ancien régime*" of native Spanish and French were most concerned about maintaining the system of successions, forced heirship, and community property brought by the Spanish, while others wanted to make sure that they would continue to be allowed to import slaves, and that their Spanish land grants that were of dubious validity would be recognized.[255] With regard to substantive civil law, *les anciens* won out, and in 1808 Louisiana's Civil Code was enacted.[256]

While discussion of whether Louisiana law is grounded more in Spanish or French origins continues,[257] concern has also been expressed that Louisiana may be losing her civilian heritage.[258] More than one scholar has argued that rather than losing her civilian heritage, Louisiana is a microcosm of the legal interaction becoming common in a global economy, and that while Louisiana has integrated new concepts into an eclectic legal mix, she has not lost her civilian roots.[259]

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250. GEORGE DARGO, JEFFERSON'S LOUISIANA: POLITICS AND THE CLASH OF LEGAL TRADITIONS 112 (1975).

251. *Id*. at 107.

252. *Id*. at 173.

253. *Id*. at 112.

254. DARGO, *supra* note 250, at 121, 173.

255. RICHARD HOLCOMBE KILBOURNE, JR., A HISTORY OF THE LOUISIANA CIVIL CODE: THE FORMATIVE YEARS,1803-1839 9-10, 31 (1987).

256. DARGO, *supra* note 250, at 160.

257. *See, e.g.*, Rodolfo Batiza, *The Louisiana Civil Code of 1808: Its Actual Sources and Present Relevance*, 46 TUL. L. REV. 4, 10-12 (1972) (French origin of Code); Robert A. Pascal, *Sources of the Digest of 1808: A Reply to Professor Batiza*, 46 TUL. L. REV. 603, 605-07 (1972) (Spanish law); Rodolfo Batiza, *Sources of the Civil Code of 1808, Facts and Speculation: A Rejoinder*, 46 TUL. L. REV. 628 (1972); A.N. Yiannopoulos, *The Early Sources of Louisiana Law: Critical Appraisal of a Controversy*, *in* LOUISIANA'S LEGAL HERITAGE 87 (Edward F. Haas ed., 1983); KILBOURNE, *supra* note 255 (Spanish).

258. T. B. Smith, *Mixed Jurisdictions*, *in* 6 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 120 & n.399 (Frederick H. Lawson, ed. 1975).

259. Zekoll, *supra* note 244, at 4; Vernon V. Palmer, *The Many Guises of Equity in a Mixed Jurisdiction: A Functional View of Equity in Louisiana*, 69 TUL. L. REV. 9 (1994).

Like other civilian jurisdictions, Louisiana defines an obligation as a legal relationship in which one person is bound to render a performance in favor of another.[260] The legal sources of obligations are a continuum from contracts (conventional obligations) to torts (offenses and quasi offenses).[261] Under the Louisiana Civil Code, all obligations are governed by a duty of good faith.[262] The doctrine of detrimental reliance is a concept that was only integrated into the Louisiana Civil Code in 1984.[263] In its entirety, article 1967 provides that

> Cause is the reason why a party obligates himself. A party may be obligated by a promise when he knew or should have known that the promise would induce the other party to rely on it to his detriment and the other party was reasonable in so relying. Recovery may be limited to the expenses incurred or the damages suffered as a result of the promisee's reliance on the promise. Reliance on a gratuitous promise made without required formalities is not reasonable.[264]

Prior to discussing this article, which reiterates the three elements of promissory estoppel delineated in section 90 of the Restatement (Second) of Contracts,[265] it is helpful to note that Louisiana originally rejected promissory estoppel as a foreign, common law concept. Although *culpa in contrahendo* has been noted and discussed in Louisiana,[266] the Louisiana Civil Code never affirmatively adopted the doctrine nor have any decisions been based on it.[267]

As with Puerto Rico, Louisiana courts have described *culpa in contrahendo* as the civilian equivalent of promissory estoppel, but with a limit: it is used as a basis for compensating one party for expenses incurred in reliance "on another party's offer to form a unilateral contract

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260. LA. CIV. CODE art. 1756; *see supra* text accompanying note 71 for exact quotation.

261. *See* LA. CIV. CODE arts. 1906, 1760, 1761, 2293, 2295, 2315, 2316; *supra* text accompanying notes 72-75.

262. LA. CIV. CODE art. 1759.

263. *Id.* art. 1967 (official comment).

264. *Id.* art. 1967.

265. *Compare* RESTATEMENT (SECOND) OF CONTRACTS § 90, quoted *supra* text accompanying n. 174.

266. Vernon V. Palmer, *Contractual Negligence in the Civil Law—The Evolution of a Defense to Actions for Error*, 50 TUL. L. REV. 1, 42 (1975); *see, e.g.*, Davilla v. Jones, 418 So. 2d 724 (La. App. 4th Cir. 1982), *rev'd*. 436 So. 2d 507 (La. 1983) (discussing *culpa in contrahendo*); Coleman v. Bossier City, 305 So. 2d 444, 447 (La. 1974) (same); Snyder v. Champion Realty Corp., 631 F.2d 1253, 1254 (5th Cir. 1980) (same); Morris v. Friedman, 663 So. 2d 19, 23 n.8 (1995) (same); Gray v. McCormick, 663 So. 2d 480, 486 (La. 3d Cir. Ct. App. 1995) (same).

267. Palmer, *supra* note 266, at 42; *see, e.g.*, *Morris v. Friedman*, 663 So. 2d 19, 23 n.3; Rubenstein & Son, Inc. v. Sperry & Hutchinson Co., 254 La. 757, So. 2d 521 (La. 1969) (J. Summers, dissenting).

where that offer is withdrawn before acceptance."[268] Alternatively, *culpa in contrahendo* has been described as "a fault in contracting which gives rise to a quasi-contractual obligation to pay the loss so incurred. The essential purpose is to afford a recovery to a person who has changed his position in reliance upon a nonenforceable contract."[269] While Jhering did premise his concept on the existence of a nonenforceable or impossible contract, the doctrine as it has developed is not limited to those situations.[270] Thus, those Louisiana cases that do discuss the doctrine present a limited understanding of its principles.

Other articles in Louisiana's Civil Code cover some of the situations that would have been protected by the more general concept of *culpa in contrahendo*, including article 1948 ("consent may be vitiated by error, fraud, or duress"),[271] and article 2452 (the sale of a thing belonging to another is null).[272] Under article 1948, the only kind of error that can nullify a contract is one that vitiates consent relative to cause.[273] In dealing with these kinds of situations, Louisiana case law provides that the party who is at fault for creating the error will be held liable for damages suffered by the innocent party.[274] Thus, the effect of article 1948 is similar to the civilian doctrine as originally developed by Jhering. However, to reiterate, Louisiana has never actively utilized *culpa in contrahendo* and has demonstrated only an incomplete understanding of the doctrine.[275] Instead, Louisiana adopted detrimental reliance as delineated in article 1967.

As drafted, the article is a very significant bridge between Louisiana's civil law and its common law neighbors. As a drafter of the article expressed it, "[f]or Louisiana lawyers both cause and consideration

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268. Snyder v. Champion RITY Corp., 631 F.2d 1253, 1255-56 (5th Cir. 1980) (also discussed in Mattar, *supra* note 212, at 112).

269. Coleman v. Bossier City, 305 So. 2d at 447, *discussed in* Mohamed Yehia Mattar, *Promissory Estoppel: Common Law Wine in Civil Law Bottles*, 4 TUL. CIV. L. FORUM 71, 111 (1988).

270. *See supra* text accompanying notes 90-113.

271. Palmer, *supra* note 266, at 42; Mirmina, *supra* note 7, at 92.

272. *See* Mirmina, *supra* note 7, at 91; Schwenk, *infra* note 275, at 95-99.

273. LA. CIV. CODE arts. 1948-1950.

274. *Id.*; Mirmina, *supra* note 7, at 91. *See generally* Palmer, *supra* note 266.

275. Possibly, the incomplete understanding may be explained by the fact that Louisiana cases describing the doctrine rely primarily on an older article describing it: Heinz Schwenk, *Culpa in Contrahendo in German, French, and Louisiana law*, 15 TUL. L. REV. 87(1940). While Schwenk's is a very scholarly work, it does not place the development of Jhering's doctrine in context, and therefore it could not provide Louisiana courts with a complete understanding of the concept. *See* Snyder v. Champion RITY Corp., 631 F.2d at 1255-56; Coleman v. Bossier City, 305 So. 2d at 447.

are meaningful, but for different reasons. Cause is important because of the Civil Code and the continental tradition it bespeaks; consideration is important because Louisiana shares a largely common-law national tradition, and as a consequence, Louisiana attorneys can hardly escape daily reference to consideration."[276]

The civilian "cause" was grounded in the canon law's stress on free will, concluding that a man might bind himself to an important transaction by a declaration of will even if he received nothing in return at the moment of his declaration.[277] Thus, "cause" covers all kinds of agreements, including gratuitous promises, and is premised on the view that a promise should be enforced because it is a promise.[278] In contrast, consideration is grounded in the bargain theory: a promise should not be enforced unless the promisor asks for and receives something in return for it.[279]

Article 1967 begins with a fairly standard definition of cause: "the reason why a party obligates himself." The rest of article 1967 serves as a limitation on the concept of cause, stating in effect that only some promises are enforceable, only some promises create obligations. As it has been described, "the second sentence of the article . . . forewarns a promisor not to trifle with the other party, but to treat him in good faith and with due regard for his own welfare so that he will not needlessly spend time and money in the reasonable expectation that the promisor will perform."[280] The third sentence limits the concept of cause, making it clear that it will not be regarded as reasonable to rely on gratuitous promises,[281] though properly formalized gratuitous donations are still recognized.[282]

The careful and self-conscious drafting of Louisiana's article 1967 shows an attempt to harmonize the civilian concept of a precontractual duty of good faith with the common law concept that such liability can only exist if the elements of promissory estoppel are present. Contrary to some discussion that the civilian approach has been incorporated in the

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276. Shael Herman, *Detrimental Reliance in the Louisiana Law—Past, Present, and Future(?): The Code Drafter's Perspective*, 58 TUL. L. REV. 707, 719 (1984).

277. *Id*. at 718.

278. *Id*.

279. *Id*; Mattar, *supra* note 212, at 87.

280. Herman, *supra* note 276, at 720.

281. *Id*.

282. *Id.* art. 1536. A gratuitous donation must be formalized either as a manual gift or reduced to writing and authenticated in order to be enforceable in Louisiana. LA. CIV. CODE arts. 1539, 1536.

revision of article 1967,[283] in practice, article 1967 has incorporated promissory estoppel into Louisiana law: "[Detrimental reliance] is designed to prevent injustice by barring a party from taking a position contrary to his prior acts, admissions, representations, or silence."[284] When applying the concept of detrimental reliance, courts applying Louisiana law look to the nature of the promise, the justifiability of the reliance, and damages resulting from that reliance.[285] Thus, article 1967 contains "common law wine" in a "civil law bottle."[286]

IV. REMEDIES

Jhering developed the idea that a promisee has two separate interests in a contract, one a positive interest and the other a negative one. A positive interest is the full interest a promisee has in the fulfillment of a contract and is the difference between the position the promisee would have enjoyed had the promisor not misperformed or failed to perform.[287] Contract damages, therefore, are an award equivalent to the amount of the positive interest. The negative interest is the difference between the position the promisee would have enjoyed had he never entered into the negotiations (or contract) with the blameworthy promisor.[288] Such negative interest extends only to the expenses and loss suffered by the promisee as a result of his reliance and is thus a tort measure of damages.[289] Jhering preferred, in a *culpa in contrahendo* situation, to award the injured party only his negative interest because it was the fault of the promisor that gives rise to liability and not the unmet expectations of the promisee.[290]

A. Preliminary Agreements

Where a contract is present, both French and American law award expectation (or "interest") damages. Under American law, while specific

283. *See* Mattar, *supra* note 212, at 137-149.

284. Orr v. Bancroft Bag, Inc., 687 So. 2d 1068, 1070 (La. App. 2d Cir. 1997); *see also* Note, Morris v. Friedman*: Detrimental Reliance and Statutory Writing Requirements*, 57 La. L. Rev. 1375, 1377 (1997) (The source of La. Civ. C. art. 1967 is the common law doctrine of promissory estoppel).

285. *See, e.g.*, Matherne Contractor, Inc. v. Grinnel Fire Protection Sys. Co., 915 F. Supp. 818, 824 (M.D. La. 1995); Carter v. Huber & Heard, Inc., 657 So. 2d 409, 411 (La. App. 3d Cir. 1995); *Bancroft Bag*, 687 So. 2d at 1070.

286. *See* Mattar, *supra* note 212, at 137-138.

287. Ben-Dror, *supra* note 16, at 148-49.

288. *Id.*; *see also id.* at 181 discussing BGB § 307.

289. *Id.*

290. *Id.* at 149.

performance may be available, the usual award sought by a plaintiff in a breach of contract action is expectation damages: the sum needed to put the plaintiff in the position he would have been in had all parties to the contract fully performed their obligations.[291] This principle applies whether the contract is a traditional one or an enforceable "agreement with open terms." It could even apply in a situation like that in *Texaco*, where the contract is termed merely an "agreement in principle" but the finder of fact concludes that a contract "in fact" existed as indicated by the parties' behavior.

While specific performance is available in France, the French have concluded that it would not be a realistic sanction in case of a breach of the obligation to negotiate: a "forced negotiation" would have scant chance of success. The amount of compensation will be limited to damages provided by the terms of the preliminary agreement itself or foreseeable damage.[292]

In the United States, courts have sometimes denied damages where an agreement to negotiate contains an explicit duty of good faith, arguing that as no contract resulted, no measure is possible. However, it has been argued that this is not a justifiable reason for rejecting an agreement to negotiate in good faith as unenforceable because the appropriate measure of damages would of course be reasonably foreseeable expenses incurred in reliance on that agreement.[293] Thus, while expectation damages are appropriate in a breach of contract suit, where the contract that is breached is only an enforceable agreement to negotiate in good faith, both French and American law are likely to award reliance rather than expectation damages.

B. Precontractual Bad Faith

1. United States

In the United States, some have argued that the Restatement (Second) of Contracts reflects the opinion of the drafters that Section 90 is reliance-based, and thus reliance damages should be the normal remedy. The language that the remedy granted for breach should "be limited as justice requires"[294] may be read as implying a limited remedy. In the past,

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291. Gregory Crespi, *Recovering Precontractual Expenditures as an Element of Reliance Damages*, 49 SW. U. L. REV. 43, 45 (1995).

292. CODE CIV. art. 1150.

293. *See infra* text accompanying note 110.

294. RESTATEMENT (SECOND) OF CONTRACTS § 90.

commentators argued that the remedy routinely granted under a theory of promissory estoppel is typically expectation damages or even specific performance,[295] but recent studies indicate that reliance damages are as likely to be awarded as expectation damages.[296] Nevertheless, the language of Section 90 indicates that the remedy allowed is based on equity and at the discretion of the court; therefore, an American court is free to award the full range of remedies based on specific performance, restitution, expectation, reliance, exemplary damages, or some other relief appropriate to the situation.[297]

Promissory estoppel is argued in a whole range of situations, but most of the time it is put forth as an alternative to a breach of contract claim: American plaintiffs' claim of choice is breach of contract because of the increased likelihood that expectation, rather than reliance, damages will be awarded.[298] In a precontractual situation, however, it may be difficult or impossible to assess expectation damages because the parties may not have negotiated terms essential to their assessment.[299] The issue then becomes the scope of reliance damages: should damages be limited to those out-of-pocket expenses clearly incurred for the unrealized contract, or may all associated costs be included.[300] For example, in a precontractual promissory-estoppel case involving an "unconscionable injury," the trial court awarded reliance damages for materials purchased and labor costs, but specifically declined to provide any award for administrative or engineering overhead because they were considered speculative and conjectural expenses.[301] However, the reviewing court reversed the decision, finding that in addition to the reimbursement of materials and labor, there was no reason for a blanket bar against the recovery of reasonable expenses that were incurred when the plaintiff expanded operations in anticipation of needing larger production capacity

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295. Yorio & Thel, *supra* note 181, at 130.

296. *See* Hillman, *supra* note 188, at 609-10.

297. 3 CORBIN, *supra* note 175, § 8.11, at 57-58.

298. Crespi, *supra* note 291, at 45. In *Texaco*, plaintiff Pennzoil was awarded $7.53 billion in punitive damages for tortious interference with contractual relations, an award undoubtedly greater than expectations damages would have been in a direct breach-of-contract suit. *See supra* text accompanying notes 127-132.

299. *See* Yorio & Thel, *supra* note 181, at 143.

300. *See id*. at 150; *see, e.g.*, *Red Owl*, 133 N.W.2d at 697 (Hoffman was awarded out-of-pocket expenses, though admittedly, he did not seek expectations damages).

301. Cyberchron Corp. v. Calldata Systems Development, Inc., 47 F.3d 39, 46 (2d Cir. 1995). *See generally* Gregory S. Crespi, *Recovering Pre-contractual Expenditures as an Element of Reliance Damages*, 49 S.W. L. Rev. 43 (1995) (arguing that pre-contractual expenditures should be included in a calculation of reliance damages).

to fulfill the anticipated contract. The reviewing court theorized that, in general, reliance damages should be limited to costs stemming from the time of the defendant's promise until such time as reliance on that promise became unreasonable.[302] Thus, under American law, though a court has free rein to grant whatever remedy it feels is appropriate, it is more likely to grant reliance than expectation damages in a precontractual situation, as well as other expenses temporally limited to those the plaintiff reasonably incurred in the course of its reliance on the defendant's promise.

2. France

As was mentioned above, under French tort theory, compensable damage must be certain and not otherwise compensated; nevertheless, the measure of recovery in case of a bad faith termination of negotiations is rather uncertain.[303] The damage may consist of the loss of time and money spent pursuant to the anticipated contract, but it will not be based upon expectation damages because that would demand speculation as to the terms of a non-existent contract and would thus be against the will of the parties.[304] Because of the requirement of certainty of compensable damage, compensation for "missed benefits" is limited, though some damage may be compensable under a "loss of a chance" to conclude the contract and make benefits.[305] As the amount of compensable damage is an issue of fact within the "sovereign discretion" of the trial court, and judges usually award a lump sum without explaining the elements on which they assessed compensation, it is difficult to study tort compensation under French law.[306] Generally, however, what American lawyers would term punitive damages are unavailable, as are expectation damages.

Under the American promissory estoppel scheme, as well as the French duty of good faith standard, for common sense reasons, damage awards lean towards reliance as opposed to expectation in precontractual situations. Theoretically, a defendant may face greater exposure in the United States under promissory estoppel than he would under France's

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302. *See id*., 47 F.3d at 46-47.

303. Schmidt-Szalewski, *France Report, supra* note 76, at 152. *See generally* Franco Ferrari, Comparative Ruminations on the Foreseeability of Damages in Contract Law, 53 La. L. Rev. 1257, 1257-1261 (1993) (tort versus contract changes in French law).

304. *See* Schmidt-Szalewski, FORMATION, *supra* note 96, at 95.

305. *Id.*

306. *Id.*

tort theory; however, in actuality the exposure under either system may be similar.[307]

To sum up the evolution of precontractual liability in French law, liability in torts remains the main response in case of breach of precontractual negotiations. The law of torts is used to control the fairness of the negotiation process. Contractual liability occurs when the existence of a precontractual agreement is demonstrated by the parties' behavior or declared intention. Nevertheless, liability must be predicated if not on the parties' agreement to a specific obligation, then on an act of bad faith that was obvious and indisputable and which caused damage to the other party who reasonably had confidence that the negotiations were to lead to a completed contract. Freedom to contract—or not to contract—remains the dominant principle of French law.[308]

V. APPLICATION OF INTERNATIONAL LAW

The previous sections of this Article dealt with standards of liability for precontractual misbehavior under French and American law and proposed a standard that harmonizes both the French adoption of the duty of good faith in negotiations and the American doctrine of promissory estoppel. This section will consider whether that harmonization would be appropriate in an international context, or in other words, whether the duty of precontractual good faith and fair dealing as set by international standards is necessarily at odds with either French or American law.

A. Vienna Convention

United Nations Convention on Contracts for the International Sale of Goods applies to transnational sales contracts, and it displaces United States law where applicable. Article 7(1) states that "[i]n the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade." The provision evoking good faith is a "hard-won compromise" between the opposing views of those delegates from civilian jurisdictions who advocated imposing a duty and those from common law countries who feared that such an imposition would grant too unrestricted a mandate to judges in an international

307. *But see* Ben-Dror, *supra* note 16, at 178 n.210. While civilian standard of damages in *culpa in contrahendo* cases is "negative" interest, the Swiss Code of Obligations gives the judge the discretion to award compensation at a higher rate than the reliance interest if he deems it equitable to do so.

308. Schmidt-Szalewski, *Precontractual Liability, supra* note 76, at 156-57.

setting.[309] The drafting of the article is so ambiguous that it is nearly impossible to determine exactly what it means,[310] but in light of the conflict attendant in its drafting, it seems unlikely that it could be read as imposing a definitive duty of good faith in a precontractual setting, although national courts are apparently reading a contractual duty of good faith into the Convention.[311] In view of this, focus is more appropriate on the Unidroit principles that are likely to have an effect on a broader range of contracts and that prescribe a clearer standard of good faith.

B. Unidroit Principles

The Unidroit Principles, drafted in 1994, are the most recent statement of international private commercial law. To be exact, the compilation is not law, but rather has the nature of a restatement and constitutes a totally new approach.[312] The Principles were drafted in response to a perceived need for formulation of a new *lex mercatoria*[313] because cross-border transactions to a large extent are still subject to national laws that vary considerably in content and are often ill-suited to the special needs of international trade.[314] The drafters of the Principles anticipate that international traders will adopt the Principles, or certain of them, as a way of opting out of the uncertainties and inconveniences of national law. Alternatively, the Principles may be used by arbitrators in the course of resolving disputes involving international commerce.

The Principles were not intended to unify existing national law, but rather to enunciate common principles and rules of existing legal systems and to select solutions best adapted to the special requirements of international commercial contracts.[315] Effort has been made to make them flexible and adaptable to constantly changing circumstances brought about by technological and economic developments, yet firm enough to

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309. Farnsworth, 3 TUL. J. INTL & COMP. L., *supra* note 83, at 54.

310. *Id*. at 56.

311. *See, e.g.*, SARL Bri Production "Bonaventure" v. Société Pan African Export, CA Grenoble, Feb. 1995, *reprinted in* UNILEX, D. 1795-7 (1995), discussed in Diana Madeline Goderre, Comment & Casenote, *International Negotiations Gone Sour: Precontractual Liability under the United Nations Sales Convention*, 66 U. CIN. L. REV. 257, 276 (1997).

312. *See* Bonnell, *infra* note 314, at 1129; Joachim Zekoll, *Kant and Comparative Law—Some Reflections on a Reform Effort*, 70 TUL. L. REV. 2719, 2728 (1996).

313. *See* Ole Lando, 3 TUL. J. INT'L & COMP. L. 129, 130 (1994).

314. Michael Joachim Bonell, *The Unidroit Principles of International Commercial Contracts: Why? What? How?*, 69 TUL. L. REV. 1121, 1122 (1995).

315. Michael Joachim Bonell, *Unification of Law by Non-Legislative Means: The UNIDROIT Draft Principles for International Commercial Contracts*, 40 AM J. COMP. L. 617, 622 (1992).

ensure fairness and consistency in international commercial relations.[316] One fundamental idea underlying the Principles is that of freedom of contract. "The parties are free to enter into a contract and to determine its content,"[317] and may exclude or derogate from the application of the Principles except as otherwise provided by the Principles themselves or other pertinent law.[318]

Though freedom of contract is protected, that freedom is limited by article 1.7, which the parties may not agree to exclude: "each party must act in accordance with good faith and fair dealing in international trade."[319] Additionally, Article 2.15 provides that:

> (1) [a] party is free to negotiate and is not liable for failure to reach an agreement; (2) [h]owever, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party; and (3) [i]t is bad faith, in particular, for a party to enter into or continue negotiations intending not to reach an agreement with the other party.[320]

In other words, under the Unidroit Principles, the parties' behavior must adhere to good faith and fair dealing throughout the life of the contract, including the negotiation process.[321] As we have seen, while this approach is familiar to most civilian systems, common law systems generally limit the duty's operation to the performance of contracts, if they admit the principle at all.[322]

Although the Principles have been criticized for not providing either definition or scope for the mandatory good faith standard,[323] nevertheless, the term is coupled with "fair dealing" and it is to be understood objectively as a synonym for "reasonable commercial standards of fair dealing."[324] Thus, it is arguable that the duty of good faith as espoused by the Principles means that a court should interpret a contract according to the meaning that reasonable parties would give to it, and that (as with *Sons of Thunder*) good faith has a supplementing function.[325] Limiting

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316. See UNIDROIT PRINCIPLES, *supra* note 2, Introduction at iii.

317. *Id.* art. 1.1 (quoted in Bonell, 69 TUL. L. REV., *supra* note 314, at 1133).

318. *Id.* art. 1.4.

319. *Id.* art. 1.7.

320. *Id.* art 2.15. In addition, the concept of good faith and fair dealing underlies a number of other provisions. Bonnell, 69 TUL. L. REV., *supra* note 314, at 1136.

321. *Id*. at 1138.

322. *Id*.

323. Farnsworth, *Duties of Faith and Fair Dealing*, supra note 83, at 56.

324. Bonell, *supra* note 314, at 1138; *see also* Farnsworth, *Precontractual Liability*, supra note 14, at 239.

325. Arthur Hartkamp, *The Concept of Good Faith in the UNIDROIT Principles for International Commercial Contracts*, 3 TUL. J. INT'L & COMP L. 65, 65 (1995).

the duty of good faith to subjective honesty-in-fact is insufficient with regard to the Principles, even in a precontractual situation.[326]

The reference to "good faith and fair dealing in international trade" is an attempt to make it clear that the two concepts are not to be applied according to the standards of national legal systems, except to the extent that they are shown to be generally accepted among the various systems.[327] Moreover, in interpreting the meaning of the duty in various contexts, reference is to be made to the standards of business practice in the trade sector at issue, as well as in reference to the special conditions of international trade.[328]

Article 2.15 implies that evidence that a party entered into negotiations with no intent of reaching an agreement will establish a presumption of bad faith, though in the absence of bad faith a party will not otherwise be liable for failure to reach an agreement. The fact that article 2.15 attempts to provide for a balance between the freedom from contract and the duty to negotiate in good faith, as well as the fact that the duty is expressed as an obligation to refrain from bad faith, indicates that the working standard developed earlier under reference to both French and American law is also appropriate in a Unidroit context. Using the language developed under French tort law, and comparable to American promissory estoppel standards, bad faith in negotiating in an international commercial context occurs when a party to negotiations (1) commits an act of wrongful behavior which would not have been committed by a reasonably prudent man under the same circumstances, (2) the unfairness or unreasonableness of the act is obvious and indisputable, and (3) the act caused damage to the other party who reasonably had confidence that the negotiations were to lead to a completed contract. As restated using American language of good faith, article 2.15 bad faith occurs when international commercial negotiations have proceeded to the point where a party's pursuit of an opportunity it should have regarded as foregone constitutes an abuse of its discretion, given the context of the negotiations.

VI. CONCLUSION

With *Sons of Thunder* as an example, the first part of this Article discussed the implied covenant of good faith and its development under American law. While the duty of good faith is now generally accepted as

326. Bonell, *supra* note 314, at 1138.
327. *Id.*
328. *Id.*

part of American contract law, civil law traditionally regards fidelity and honesty as a fundamental concept of contract law. The civilian concept developed from the Roman *bona fides*, while the common law concept resembles more the Roman *stricti juris*.[329] As a result of the difference in the theoretical underpinnings of contract law, civilians accept the concept of a precontractual duty of good faith, while common law jurists hesitate to recognize such a duty.

Good faith is a concept that is difficult to define, and several different definitions have been explored. Definitions have focused on (1) concepts of morality;[330] (2) expected benefits (defining bad faith as behavior that interferes with reasonable expectations);[331] (3) excluder analysis (listing types of bad faith behavior);[332] and (4) discretion and foregone opportunities.[333] To a certain extent, all of these definitions lack authority: "an assertion that good faith is the abstention from recapturing foregone opportunities does not have greater definitional value than the assertion that a party's good faith is the duty to do whatever is necessary not to deprive the other of the benefit of the contract."[334]

However, the notion that good faith means the absence of bad faith, found in both American and French law, is not a circular redundancy. One cannot make any specific demands of good faith. It is only the absence of good faith—bad faith—that is actionable, as seen in *Sons of Thunder*. This definition by excluder analysis should obviate the concern of those who are worried that the notion of good faith implies a sort of common good that would lead to state paternalism. In fact, the concept of promissory estoppel has more tendency to judicial paternalism because of the lack of clarity inherent in its third element. In contrast to promissory estoppel, the issue of whether a party to negotiations has behaved in bad faith is determined without an appeal to any metaphysical collective good beyond the specific interests of the parties involved.

Moreover, legal principles are not scientific hypotheses developed and intended to guide scientific inquiry. One does not invent a legal theory out of thin air and then look around to see if it proves true in the real world. Legal principles necessarily are dependent suppositions that

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329. *See* Litvinoff, *supra* note 68, at 1651; Tête, *supra* note 68, at 56-58.
330. *Schaller*, 131 Wis.2d at 402 (discussed *supra* text accompanying note 27).
331. Farnsworth, *supra* note 55, at 669.
332. Summers, *supra* note 56, at 200-207 (discussed *supra* text accompanying note 59).
333. Burton, *supra* note 21, at 369 (discussed supra text accompanying notes 64-65).
334. Litvinoff, *supra* note 68, at 1668.

arise as abstractions from already existing legal activities.[335] Similarly, a cook book is not an independently generated beginning from which cooking can spring; it is instead an abstract of somebody's knowledge of how to cook: it is the child, not the parent, of the activity.[336] The appropriate kitchen for developing a recipe for good faith in a common law system is the courtroom. It is only after a number of decisions have been made determining what constitutes bad faith in a precontractual situation that theorizing about the concept of good faith will retain any kind of shape.

The second section of this Article considered various kinds of preliminary agreements in both American and French law. Because of the common law emphasis on the bargain and its focus on the intent to be bound, preliminary agreements are less likely to be regarded as enforceable under American common law. Though both traditions consider the expressed intent of the parties as indicia of enforceability, French contract law focuses more on the presence of an agreement that gives rise to specific obligations.

When there is no contract or preliminary agreement, both French and American law agree that contract law is inapplicable. Thus, precontractual misbehavior must be sanctioned under tort or equity theories. French law predicates liability for precontractual bad faith on the presence of an obvious and indisputable fault in behavior (as measured by the reasonable man standard), the substantial, justified and foreseeable reliance of the other party, causation, and certain and quantifiable damage. American law typically resorts to the doctrine of promissory estoppel, demonstrated by (1) a clear and unambiguous promise, (2) a reasonable and foreseeable reliance, and (3) a finding that justice requires enforcement of the promise. The third element is key because it requires a normative decision by the court about whether the promisor's behavior was appropriate in the context of the negotiations, but courts typically avoid discussion of the third element, as demonstrated by *Hoffman v. Red Owl*.

Using language that has developed through discussion of the American contractual duty of good faith, a more flexible, direct, and accurate phrasing of the *de facto* precontractual duty of good faith becomes possible: precontractual bad faith occurs when negotiations have proceeded to the point that a party's pursuit of an opportunity it

335. Michael Oakshott, *Political Education*, *in* THE VOICE OF LIBERAL LEARNING: MICHAEL OAKSHOTT ON EDUCATION 143 (Timothy Fuller ed. 1989).

336. *Id.*

should have regarded as foregone constitutes an abuse of its discretion, given the context of the negotiations. Opportunistic behavior is sanctionable.

Out of regard for the importance of freedom from contract, both French[337] and American[338] law are very hesitant to impose liability unless the precontractual misbehavior is obvious, beyond dispute or even unconscionable. The measure of damages under either system is likely to be reliance, not expectation or specific performance for practical as well as theoretical reasons.

The fourth and final part of the Article examined whether the approach to a precontractual duty of good faith synthesized in the previous discussion would be applicable to the concept mandated by the Unidroit Principles. The Principles are intended to be used in international commercial transactions, and they avoid the application of any particular national standard, except that they establish a duty of precontractual good faith the scope of which is proportional to the context of the negotiations in question. The standard synthesized in the earlier portion of the article, whether stated in terms of a tort standard or in terms of a "foregone opportunity" standard, seems to be an appropriate expression of the objective standard envisioned by the drafters of the Principles.

With regard to the efficacy of promissory estoppel, predicating liability on the need to give justice to the relying party necessarily involves a determination that the promisor behaved in bad faith. There can be no bad faith behavior without presupposing an underlying duty of good faith. This avoidance by the courts means that it is harder to determine what constitutes good faith in a precontractual situation. The implicit but unexpressed recognition of good faith granted in the doctrine has led to inconsistent application, and this backlog of incoherent precedents may be adding to courts' reluctance to grant relief under promissory estoppel.

One of the beauties and strengths of the civilian system is its attempt to provide a coherent statement of the law.[339] In contrast, the traditional strength of common law is its acknowledgment that there is no final definitive formulation of a norm. It is a series of decisions, and analysis of those decisions, that give shape to that norm. As formulated by the Restatement, promissory estoppel avoids the heat of decision-making

337. NICHOLAS, *supra* note 3, at 71.
338. *See generally* Pham, *supra* note 181.
339. *See* Têtе, *supra* note 67, at 49.

about the appropriate standard of behavior in precontractual relations. It acts as a legal fiction and prevents common law courts from serving their traditional function.

A common concern of American lawyers is that the imposition of a precontractual duty of good faith would interfere with the freedom from contract, encourage unnecessary litigation, and result in a hesitancy to engage in business. It can be argued, however, that the absence of a clear and coherent standard obfuscates the contractual process and is itself an obstacle to business. A straight-forward standard would encourage attorneys to facilitate negotiations, not necessarily encourage litigation.

The aim of this Article has been to see if American legal philosophy can be reconciled to the existence of a precontractual duty of good faith as understood in a civilian context and employed in an international arena. The benefits of such a reconciliation would be several. One of the aims of comparative legal studies is to search the market place of ideas for better, more accurate legal tools that are more responsive to real world problems. This market place approach can benefit individual jurisdictions who adopt the better tools. Additionally, the market place approach is superior to politicized harmonization attempts because it promotes a race to the top—to the most effective ideas—as opposed to a race to the bottom.[340]

The greatest aspiration of this article, however, is that it should demonstrate the value of the study of comparative law. The study of other systems helps to clarify one's own system.[341] Additionally, comparative law aims at "procuring the gradual approximation of view points, the abandonment of deadly complacency, and the relaxation of fixed dogma—and it permits us to catch sight, through the differences in detail, of the grand similarities and so deepen our belief in the existence of a unitary sense of justice."[342]

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340. Prof. Dr.iur. Dr.rer.pol. Christian Kirchner, LL.M., *The Formation of European Law: Contract Law, Competition Law, and Accounting Law—Three Different Types of Legal Harmonization* (lecture given on March 6, 1997, at Tulane Law School).

341. 1 KONRAD ZWEIGERT, INTRODUCTION TO COMPARATIVE LAW 3, 15 (1987) (trans. Tony Weir).

342. *Id.* at 3.