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A Comparative Legal Study of Preliminary Agreements under French and American Law.

by

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Abstract

This thesis is a comparative legal study of preliminary agreements in French and American law.

At the negotiation process, a preliminary agreement has numerous purposes. Those purposes vary with the parties' will. The contrasted concept of preliminary agreement and its hybrid legal nature give rise to legal issues, such as interpretation, enforceability and liability. Those issues are differently tackled in French and American law.

The ambiguity of pre-agreements allows the French and American judges to play a decisive role in the interpretation of such agreements. In accordance with its definiteness and completeness, the pre-agreement may be considered as the final contract and binds the parties. Then, in case of non respect, the blameworthy party may be held liable, and courts may grant damages to the party who has suffered prejudice.

Résumé

Ce mémoire est une étude juridique comparée des accords préliminaires en droit français et américain.

A la phase des négociations, un accord préliminaire peut avoir plusieurs objectifs. Ces objectifs varient en fonction de la volonté des parties. Le caractère ambivalent des accords préliminaires et leur nature juridique hybride donnent naissance à des problèmes juridiques majeurs tels que l'interprétation, la force juridique et l'éventuelle responsabilité en cas de non respect du contrat préliminaire. Ces problèmes sont abordés de façon différente en droit français et américain.

L'ambiguité des accords préliminaires donne un large pouvoir d'interprétation aux juges français et américains. Si l'accord préliminaire est suffisamment précis et complet, celui-ci pourra être considéré comme l'accord final et liera les parties. En conséquence, en cas de non respect de l'accord, la partie défaillante pourra être responsable et condamnée à dédommager la partie adverse si elle a subit un préjudice.

TABLE OF CONTENT

INTRODUCTION

The purpose of the thesis is to study the legal concept of preliminary agreements in the context of business negotiations, under French and American law.

Preliminary agreements are important instruments in the pre-contractual process. By definition, a preliminary agreement is, in its essence, provisory and implies the subsequent conclusion of a final and formal contract. The parties are bound only because they have agreed to prepare a contract that should follow the pre-agreement. However, a preliminary agreement has several purposes that vary with the parties' will. A preliminary agreement can be a simple declaration or an elaborate document resembling a contract.[1] It is of a hybrid legal nature.

Preliminary agreements are drafted at the beginning of the negotiation process, most frequently by non-legal staff. The words used are often vague and ambiguous. At this moment, parties are not preoccupied by legal issues and are not always aware of the possible legal consequences of the signing of a pre-agreement. The evolution of the negotiation process and the wording used by the parties may lead to the recognition of the preliminary agreement as the final contract. Consequently, the ambivalent and contrasted concept of preliminary agreement leads to numerous legal issues, such as interpretation, enforceability and liability.

Those issues are differently considered in the United States and in France. American courts usually recognize restricted legal consequences to preliminary agreements, whereas

[1] R.B.Lake and U.Draetta, *Letters of Intent and Other Precontractual Documents. Comparative Analysis and Forms* (Stoneham, Mass.: Butterworth Legal Publishers, 1989), at 6.

French courts handle those agreements with larger latitude. This difference results from the divergent view on contracts in the common law and civil law systems. On the one hand, the Common law emphasizes the bargain aspect and its inherent risks, and on the other hand, Civil law leans toward the relationship aspect.

Chapter I. The scope of preliminary agreements

A. The growing importance of preliminary agreements in the negotiation process

Modern negotiations are characterized by the multiplicity of preliminary agreements. The drafting of pre-contractual agreements is an important phase preceding or coming with the negotiation stage.

In the business world, pre-contractual instruments are named "letter of intent", "heads of agreement", "memorandum of understanding", "memorandum of intent", "agreement in principle" (*accord de principe*), "agreement to negotiate" (*accord de négociation*) and "protocol" (*protocole d'accord*). The term "letter of intent" is the one that is frequently used in France and the United States.[2]

Those several names given to preliminary agreements indicate that the parties are willing to avoid the term "contract". Thus, for the parties, those preliminary documents appear to be less constraining than a formal contract, at least psychologically.[3]

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[2] *Ibid.* at 4-5.

[3] F.Labarthe, *La Notion de Document Contractuel*, (Paris: LGDJ, 1994), at 142.

A letter of intent is usually signed at the beginning of the negotiations. It may be unilateral or signed by both parties. The signing of a document is psychologically very important for the parties. Even if they do not want to feel bound, businessmen consider the letter of intent to be ethically and morally binding.[4] It officially shows the beginning of the negotiations.

Business people are usually reluctant to involve lawyers at the beginning of the negotiations. Lawyers seem to be an obstacle for a friendly first contact with the possible future commercial partners. The use of letters of intent is a convenient way not to involve lawyers at the beginning of the negotiation process, and to separate commercial terms from legal terms that are viewed as the "arcane boilerplate".[5]

American courts are aware of the important role of preliminary documents in the business world. In *Schwanbeck* v. *Federal-Mogul Corp.*,[6] the Massachusetts Court of Appeals highlights the time and efforts gained by the conclusion of preliminary agreements in a aim to reach a final contract.

The identifying of key elements in pre-contractual documents accelerates the formation of the contract. The letter of intent focuses attention. From an economic point of view, the letter of intent constitutes the evidence that serious negotiations have been

[4] Business people "usually comply with such agreements for a variety of economic and psychological, if not strictly moral, reasons."
R.B.Lake and U.Draetta, ***supra*** note 1 at 10-11.

[5] ***Ibid.*** at 10.

[6] *Schwanbeck v. Federal-Mogul Corp.*, 578 N.E.2d 789 (Mass. App. Ct. 1991).

undertaken and it may help to obtain financial means and capital investment. It indicates the seriousness of parties' intentions.[7]

In general, letters of intent encourage parties to have a constructive attitude during the negotiations, *i.e.*, to negotiate with a view to reach a final contract.[8]

B. The purpose of preliminary agreements

Letters of intent can be very long and detailed, and may therefore have the appearance of a contract. The term "letter of intent" is given to many types of document.[9]

The difference between the various preliminary agreements is not made by their name, but by their content. The scope of a preliminary agreement actually varies with its content.

A letter of intent may refer to the conduct of the negotiations, or contain the descriptions of items to be purchased or services to be performed.[10] It may serve to impose confidentiality on information given during the negotiation process, or to impose confidentiality on the evolution of the negotiations themselves.[11] They are essential for

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[7] See. J. Klein and C. Bachechi, "Precontractual liability and the duty of good faith negotiation in international transactions", (1994) 17 Hous. J. Int'l L. 1, at 5.

[8] P. Jourdain, *La bonne foi dans les relations entre particuliers- Dans la formation du contrat. Rapport français*, Travaux de l'Association Henri Capitant, Tome XLIII (Paris: Litec, 1992), at 127.

[9] R.B.Lake and U.Draetta, ***supra*** note 1 at 6.

[10] ***Ibid.*** at 10.

[11] J-M. Loncle and J-Y Trochon, "The negotiating phase of international contracts" (1997) 1 IBJL 3, at 3.

complex negotiations, as several consents will be given on various points at different stages of the negotiations.[12]

1. Preliminary agreements organizing the negotiations

Modern business transactions require the exchange of numerous documents (fax, memos, notes, letters, propositions,...).

Negotiations may involve several documents relating to different points or stages of the final agreement. Those documents may contain hundreds of pages. The negotiation process may also involve third parties such as financial institutions, government agencies or consultants. Under those circumstances, the pre-contractual agreement is necessary to bring order in such a complexity.[13] For instance, it may organize the timetable or fix the share of the costs and expenses occurred during the negotiations.[14]

2. The contract to negotiate

The contract to negotiate is also called "agreement to agree" and "contract to bargain".[15]

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[12] ***Ibid.*** at 25-26.
In such case, letters of intent serve to record preliminary consents that could be forgotten in the process of complex transactions.

[13] R.B.Lake, "Letters of Intent: a Comparative Examination Under English, U.S., French and West German Law", (1984) George Wash.J. of Int'l Law & Economics, 331, at 332.

[14] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 5.

[15] "Use of the verb form "to bargain" (rather than "contract of bargain" or just "bargain contract") is intentional, in the hope of stressing the process of bargaining which remains to be performed, rather than the agreement (if any) which will result therefrom."
C.L.Knapp, "Enforcing the Contract to Bargain," (1969) 44 N.Y.U.L.Rev. 685.

The contract to negotiate is a temporary contract, creating obligations only for the pre-contractual period. Nonetheless, some obligations, like the duty not to disclose or to use know-how, may be preserved after the failure of the negotiations. In that case, the duration of the obligations should be foreseen in the preliminary agreement. If not, the duration of the obligation will be decided by the judge.[16] The parties can also foresee damages in case of the breach of such obligations.

3. Letters of intent contemplating a future contract

This letter of letter of intent is defined as being "a pre-contractual written instrument that reflects preliminary agreements or understandings of one or more parties to a future contract."[17] Burton and Andersen define it as "one made during bargaining on the assumption that further negotiations will take place and result in a later, final contract."[18] This letter of intent is considered as the foundation of a final contract. Those definitions indicate that the letter of intent is of a pre-contractual nature and not contractual.[19]

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[16] See. J.Schmidt. *Négociation et Conclusion de Contrats*. (Paris: Dalloz. 1982). at 256-260.

[17] R.B.Lake and U.Draetta. ***supra*** note 1 at 5.

[18] S.J. Burton and E.G. Andersen. *Contractual Good Faith: Formation, Performance, Breach, Enforcement*. (Boston: Little Brown. 1995). at 348-349.

[19] R.B.Lake and U.Draetta. ***supra*** note 1 at 5.

Those preliminary agreements aim to prepare the future contract.[20] They are normally temporary and are designed to be replaced by the final agreement. They usually contain provisions stating the parties' intention and reflect the progression of their will. These documents have a great importance for the parties. The signing of a document, even if it contains general statements, will symbolise the beginning of their eventual future commercial collaboration.[21]

Important obligations such as price or defective performance are usually left to the final stage of negotiations.[22] Thus, it is not surprising to find open terms in letters contemplating a future agreement. They are to be settled in the final agreement. Most of time, a lawyer will undertake to later draft a more detailed document.[23]

4. Obligations specific to the negotiation period

The particular period of negotiations gives rise to specific obligations. Those specific obligations are, among others: collaborating to reach a positive solution, acting to resolve difficulties that may arise during the negotiations, making no unfair proposals.[24]

Several specific clauses are systematically included in pre-contractual agreements.

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[20] J.Schmidt-Szalewski. *French report*. in E.H.Hondius. ed.. *Precontractual liability. Reports to the XIIIth congress*. International Academy of Comparative Law. Montreal. Canada. 18-24 August 1990. (Deventer: Kluwer Law and Taxation Publishers. 1991). at 148.

[21] J-M. Loncle and J-Y Trochon. ***supra*** note 11 at 7.

[22] R.B.Lake and U.Draetta. ***supra*** note 1 at 10.

[23] J-M. Loncle and J-Y Trochon. ***supra*** note 11 at 7.

[24] See. 94ème Congrès des Notaires de France. *Le Contrat. Liberté contractuelle et Sécurité juridique*. (Lyon. 17-20 mai 1998). at 32. **[hereinafter 94ème Congrès des Notaires de France]**.

The clause of exclusivity prevents the parties from negotiating with third parties. It may require to negotiate on an exclusive reciprocal basis.[25] The clause of sincerity obliges the parties to reveal any negotiations with third parties.[26]

The clause of confidentiality obligates the parties not to reveal the negotiations undertaken. For instance, in the context of a transfer of a company, the contracting parties are willing not to worry their financial partners, their staff and their clients. They prefer being discreet on the course of the negotiations.[27]

The clause of confidentiality may also prevent the parties from disclosing confidential information exchanged during the negotiations.[28]

"Good faith" and "best efforts" clauses aim to impose on parties an obligation to negotiate in good faith or to use best efforts to reach a final contract.[29]

The parties can also contemplate the failure of the negotiations. For instance, they may foresee the disposal of documents like analysis, expertise, plans,... that have been created for the purpose of the deal.[30] They can also specify that no damages could be claimed in case a final contract is not reached.[31]

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[25] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 5.

[26] P. Jourdain, ***supra*** note 8, at 129.

[27] 94ème Congrès des Notaires de France, ***supra*** note 24 at 33.

[28] P. Jourdain, ***supra*** note 8, at 129.

[29] See, ***infra*** Chapter II. B. The legal impact of the principle of good faith on preliminary agreements.

[30] 94ème Congrès des Notaires de France, ***supra*** note 24 at 35.

[31] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 8.

Mr. Pevtchin has made the further statement on letters of intent: "you find in it what you have brought".[32] A letter of intent may have many purposes. Thus, it is difficult to give a single and precise definition.

Several types of letter of intent and their purposes in the negotiation context will be presented. The thesis will particularly focus on the following types of preliminary agreement: the contract to negotiate, the contract to negotiate in good faith, the agreement with open terms and the letter of intent contemplating a future agreement.

[32] G.Pevtchin, "La lettre d'intention," (1979) Droit et Pratique du Commerce international, at 49.

Chapter II. Preliminary agreements and the principle of good faith

Parties entering into negotiations are primarily supposed to be willing to reach a final agreement. Behaviors contrary to this purpose constitute a deception. Parties are deemed to act positively towards the conclusion of a contract. They are deemed to behave in good faith during the negotiation phase.

American and French law have a different approach towards the good faith duty at the pre-contractual phase. This duty is more easily accepted in France than in the United States.

In certain situations, the presence of a preliminary agreement may imply an obligation to negotiate in good faith. On the other hand, some pre-agreements explicitly aim to impose on parties an obligation to negotiate in good faith.

A. The application of the principle of good faith at the negotiation stage

1. The principle of good faith

a) The historical civil law approach

Good faith and fair dealing have been, from time immemorial, a fundamental commandment of social behaviors.

In the Christian world, long before the intervention of legal systems, fairness was the basis of every dealing, imposed by ancient and rigid customs. "Good faith in dealings and negotiation practices was the element of binding value in these ancestral societies, and served as the religious basis for maintaining the word given."[33]

The canonists considered good faith as a universal moral norm, rather than a social norm. In Canon Law, failing or refusing to keep one's promise was a breach of duty to God. Thus everyone had to act in a reasonable manner. This was a subjective moral standard based on individual honesty.[34]

For the Greeks, good faith was a universal social force that governed their social interrelationships. Each citizen had an obligation to act in good faith with regard to all citizens.[35]

The Carthaginians have related the following:

> There is a country in Libya, and a nation, beyond the Pillars of Heracles, which they are wont to visit, where they no sooner arrive but forthwith they unlade their wares, and, having disposed them after an orderly fashion along the beach, leave them, and, returning aboard their ships, raise a great smoke. The natives, when they see the smoke, come down to the shore, and, laying out to view so much gold as they think the worth of the wares, withdraw to a distance. The Carthaginians upon this come ashore and look. If they think the gold enough, they take it and go their way; but if it does not seem to them sufficient, they go aboard the ship once more, and wait patiently. Then the others approach and add to their gold, till the Carthaginians are content. Neither party deals unfairly by the other: for they themselves never touch the

[33] N.W.Palmieri. "Good Faith Disclosures Required During Negotiations". (1993) 24 Seton Hall L.Rev. 70. at 80.

[34] E.M.Holmes. "A Contextual Study of Commercial Good Faith: Good-Faith Disclosure in Contract Formation". (1978) 39 U.Pittsburgh.L.Rev. 381. at 402-403.

[35] ***Ibid.*** at 402.

> gold till it comes up to the worth of their goods, nor do the natives ever carry off the goods till the gold is taken away.[36]

The concepts of good faith and fairness of the exchange have been identified by the natural law philosophy of Hugo Grotius[37] and Samuel Pufendorf.[38] The norm of fairness provides a fundamental basis for many doctrines dealing with the notion of substantive fairness. The civil law notion of a "fair contract" and the common law doctrine of unconscionability[39] come from this fundamental basis.[40]

The idea of *bona fides* (good faith), conceived as loyalty and fairness, was the basis for trade in the ius gentium. It was well recognized that the scope of *bona fides* was much broader, even though one of its most important aspects was its negation of bad faith. The great Roman jurist Quintus Mucius Scaevola noticed that this duty permeated Roman law in general and specifically Roman contract law.[41]

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[36] See. F.R.B. Godolphin ed. & G. Rawlinson trans.. *The Greek Historians. The Complete and Unabridged Historical Works of Herodotus* (New York. Random House. 1942).

[37] See. Hugo Grotius. Francis W. Kelsey trans.. *The Law of War and Peace. De Juri Belli ac Pacis. libri tres* (Indianapolis: Bobbs-Merrill. 1925).

[38] See. Samuel Pufendorf. *The Law of Nature and Nations: De Jure Naturae et Gentium Libri Octo* (Oxford: the Clarendon Press. London H. Milford. 1934).

[39] Unconscionability is defined as a term "so unreasonably detrimental to the interest of a contracting party as to render the contract unenforceable." This rule is codified in Section 2-302 of the Uniform Commercial Code: "the basic test is whether. in the light of the general commercial background and the commercial needs of the particular trade or case. the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract."

[40] L.A. DiMatteo. "An International Contract Formula: The informality of International Business Transactions plus the Internationalization of Contract Law Equals Unexpected Contractual Liability" (1997) 23 Syracuse J. Int'l L. & Com. 67. at 88.

[41] N.W. Palmieri. ***supra*** note 33 at 81.

Good faith is primarily a question of intuition. The parties have to respect moral rules. There are two aspects in good faith behavior: first there is a subjective aspect in which good faith combines with loyalty, and second there is an objective aspect in which the person that has a good faith behavior is the one that acts reasonably.[42]

b) The American legal approach

Several American authors have attempted to give a definition of good faith and fair dealing. It has been variously defined as requiring decency as well as fairness and

[42] D.Tallon, "Le concept de bonne foi en droit français du contrat", Saggi, Conferenze e seminari, Rome 1994. <Http://www.cnr.it/CRDCS/Tallon.htm> (last modified:30 December 1999).
The Reasonable Man is "the one who invariably looks where he is going, and is careful to examine the immediate foreground before he executes a leap or a bound; who neither star-gazes nor is lost in mediation when approaching trap-doors or the margin of a dock; who records in every case upon the counterfoils of cheques such ample details as are desirable, scrupulously substitutes the word "Order" for the word "Bearer", crosses the instrument "a/c Payee only", and registers the package in which it is dispatched; who never mounts a moving omnibus, and does not alight from any car while the train is in motion, who investigates exhaustively the bona fides of every mendicant before distributing alms, and will inform himself of the story and habits of a dog before administering a caress; who believes no gossip, nor repeats it, without firm basis for believing it to be true; who never drives his ball till those in front of him have definitely vacated the putting-green which is his own objective; who never from one's year's end to another makes an excessive demand upon his wife, his neighbours, his servants, his ox, or his ass; who in the way of business looks only for that narrow margin of profit which twelve men such as himself would reckon to be "fair", and contemplates his fellow-merchants, their agents, and their goods, with the degree of suspicion and distrust which the law deems admirable; who never swears, gambles, or loses temper; who uses nothing except in moderation, and even while he flogs his child is meditating only one the golden mean. Devoid, in short, of any human weakness, with not one single saving vice, sans prejudice, procrastination, illnature, avarice, and absence of mind, as careful for his own safety as he is for that of others, this excellent but odious character stands like a monument in our Courts of Justice, vainly appealing to his fellow-citizens to order their lives after his own examples". Further the author makes he following observation: "there is no single mention of a reasonable woman."
A.P. Herbert, *Uncommon Law*, 1st ed. (Garden City, N.Y.: Doubleday, Doran, 1936), at 3-5.

reasonableness,[43] fairness,[44] and community standards of fairness, decency and reasonableness.[45]

Rather than trying to give a legal definition of good faith, some authors have undertaken to define it in a negative way. They have identified bad faith behaviors.

For Professor Ellhingaus, good faith in law is "a standard rather than a rule, principle, or concept and is closely related to residual categories."[46]

In Farnswoth' words, good faith is "what remains after the categories of bad faith have been excluded."[47] The National Labour Relations Act, requiring fair dealing in labor negotiations, has inspired Professor Farnsworth who has identified several instances of unfair dealing: refusal to negotiate, improper tactics, extreme inflexibility, unreasonable proposals, nondisclosure, parallel negotiations, reneging and, in some circumstances, breaking off negotiations.

However, for Professor Farnsworth, the traditional aleatory view should be the principle at the stage of the negotiations. The traditional common law view of negotiations holds that "mere participation in pre-contractual negotiations is not enough to create

[43] E.A. Farnsworth, "Good Faith and Commercial Reasonableness under the Uniform Commercial Code", (1963) 30 U.Chi.L.Rev. 666, at 667-668.

[44] R.A. Hillman, "Policing Contract Modifications under the U.C.C.: Good Faith and the Doctrine of Economic Duress", (1979) 64 Iowa L. Rev. 849, at 877.

[45] R. Thigpen, "Good Faith Performance Under Percentage Leases", (1981) 51 Miss. L.J. 315 at 320.

[46] M.P.Ellinghaus, "In Defense of Unconscionability", (1968-69) 78 Yale L.J. 757, at 759.

[47] E.A.Farnsworth, "Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 Colum I. L. Rev. 217, at 273-284.

binding obligations, even if the parties reach a preliminary agreement."[48] Imposing a fair dealing duty does not signify that the negotiations will effectively take place in a fair atmosphere. Moreover, such obligation might discourage parties from entering into negotiations.[49]

Professor Summers argues that it is inappropriate to ascribe any particular definition to the term good faith and fair dealing. According to him, the concept of good faith and fair dealing is an "excluder" in that it simply excludes certain bad faith behaviors. This notion of "excluder" has no precise meaning, but it serves to exclude many heterogeneous forms of bad faith. Professor Summers has identified six categories of bad faith behaviors: evasion of the spirit of the deal, lack of diligence and "slacking off," wilful rendering of only "substantial performance," abuse of a power to specify terms, abuse of power to determine compliance, and interference with or failure to cooperate in the other party's performance.[50]

Professor Knapp has described bad faith in the negotiation stage as "a unilateral withdrawal from negotiations or at least an insistence on terms so clearly unreasonable that they could not have been advanced with any expectation of acceptance, coupled with some demonstrable advantage to be gained by defendant in avoiding the contemplated transaction."[51]

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[48] J. Klein and C. Bachechi, ***supra*** note 7 at 4-5.

[49] E.A. Farnsworth, ***supra*** note 47 at 242-243.

[50] See R. S. Summers, "'Good Faith' in the General Contract Law and the Sales Provisions of the Uniform Commercial Code", (1968) 54 Va. L. Rev. 195.

[51] C.L. Knapp, ***supra*** note 15 at 723.

Good faith imposes an obligation to negotiate with loyalty and honesty in view of security and efficiency of the future transaction.

Because of the absence of a strict definition of good faith by courts and scholars, it is not possible to determine if the concept of good faith is purely subjective, *i.e.*, the party *honestly* believes that she is acting properly; or if the concept is purely objective, *i.e.*, besides the belief, the party acts in a *reasonable* manner. The parties could determine the standard themselves in a pre-agreement,[52] but they usually neglect it and therefore the definition is commonly made by the courts.[53]

2. The deciding role of the French Civil Code and the American Uniform Commercial Code in the implementation of good faith

a) Good faith: an overriding principle of French contract law

The concept of good faith is an essential component of the civil law systems. It particularly plays a major role in contract law. It is a general principle, overriding all the rules of civil law contracts.[54]

For instance, Article 1372 of the Civil Code of Quebec provides that good faith shall govern the conduct of the parties at the moment of the birth, the execution or the

[52] See, ***infra*** Part B. 2. The contract to negotiate in good faith

[53] A.E.Farnsworth, "The Concept of "Good Faith" in American Law", centro di studi e ricerche di diritto comparato e straniero (Rome 1993). <http://www.cnr.it/CRDCS/farnswrt.htm> (last modified: 30 December 1999).

extinction of the obligation.[55] The Civil Code of Netherlands, in its Article 6.2 para.1, uses the terms "reason and equity."

The French Civil Code (hereinafter the Civil Code) is the product of legal scholars and is based on many philosophical concepts. The canonist tradition and the moralist conception of Natural Law have inspired the concept of good faith.[56] Although the concept of good faith has always been considered as a fundamental notion of contract law by the drafters of the Civil Code, the French Civil Code has no general principle relating to good faith. Article 1134 para.3, relating to good faith, only concerns the execution of contracts.[57] However, it is commonly admitted, by the courts and the authors, that Article 1134 para.3 actually reflects the principle of good faith in contract law in general and that good faith is an overriding principle of contract law.[58]

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[54] E.A. 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 Law". (1995) 3 Tul. J. Int'l & Comp. L. 47. at 60.

[55] Article 1372 of the civil code of Quebec: "la bonne foi doit gouverner la conduite des parties, tant au moment de la naissance de l'obligation qu'à celui de son exécution ou de son extinction."

[56] D.Tallon, ***supra*** note 42.

[57] Article 1134: "les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites.
"Elles ne peuvent être révoquées que de leur consentement mutuel, ou pour les causes que la loi autorise.
"Elles doivent être exécutées de bonne foi."
In the project of the civil code of Year VII (Code civil de l'An VII), there was an article providing that conventions have to be concluded and executed in good faith. For a question of structure of the final civil code, the reference to good faith in the formation of contract has not been reviewed. The current article 1134 is a part of the chapter "The effect of obligations".
D.Tallon, ***supra*** note 42.

[58] J. Schmidt, ***supra*** note 16 at 206.

To sum up, the application of a good faith duty at the pre-contractual phase implies the recognition of a general principle of good faith of which Article 1134 para.3 is an application.[59]

Although good faith has always been a fundamental concept of contract law, French lawyers and judges have forsaken it for decades. It has gained importance in the sixties, when the doctrine, as well as the judges, have started to be anxious to protect the weak parties in transactions. In 1985, for the first time, the *Cour de cassation*[60] accepted an appeal based on Article 1134 para.3 of the Civil Code.[61] The *Cour de cassation*, considering that it is a factual question, refuses to define good faith and leaves this duty to the courts of lower level.[62] Thus, there is no unique definition of good faith in French case law.

The concept of good faith is actually at the heart of the entire French contract law. Freedom of contract has to take into account justice and loyalty.[63] The good faith doctrine emphasizes the supremacy of contractual justice over contractual freedom.[64]

The courts admit the existence of a good faith obligation at the stage of the negotiations.

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[59] P. Van Ommeslaghe, *La bonne foi dans les relations entre particuliers*- in *La formation du contrat. Rapport général, Travaux de l'Association Henri Capitant, Tome XLIII* (Paris: Litec, 1992), at 30.

[60] The French Supreme Court

[61] Civ.I. 20 mars 1985, B.1985 I., no.102.

[62] The *Cour de cassation* does not judge the facts of the case. It only considers the application of law.

[63] J.Ghestin, *Traité de droit civil. La Formation du Contrat*., (LGDJ: Paris, 1993), at 41-42.

Bad faith and lack of loyalty characterize pre-contractual wrongful behaviors. In practice, bad faith would consist of "any behavior that deceives the other party's confidence": breach of negotiations (whereas the other party could reasonably expect the contract to be concluded), disclosure or use of confidential information on purpose in order to deceive or to cause a prejudice to the opposite side, erroneous information given about the elements of the negotiated contract.[65] It can also be characterized by: entering into negotiations without any intention to conclude a contract, raising new and unreasonable demands during negotiations, rejecting systematically reasonable offers, revoking offers previously made, putting forward modifications in order to continually extend negotiations, requesting further benefits or imposing new obligations on the other party.[66]

b) The role of the Uniform Commercial Code in the United States

In 1766, Lord Mansfield referred to good faith as "the governing principle... applicable to all contracts and dealings,"[67] but this principle never took roots in England.

The doctrine of good faith has been, however, admitted in the United States. The contemporary recognition of the doctrine of good faith began with Professor Karl Llewellyn, Chief Reporter for the Uniform Commercial Code (hereinafter the U.C.C.).[68]

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[64] J.Schmidt-Szalewski, ***supra*** note 20 at 157.

[65] ***Ibid.*** at 152.

[66] See. P. Van Ommeslaghe, ***supra*** note 59 at 41.

[67] *Carter v. Boehm*, [1766] K.B. 1162, 1164, Eng. Rep. 97.

[68] E.A. Farnsworth, ***supra*** note 43 at 667-668.

Professor Llewellyn, a former teacher at Leipzig in Germany, was inspired by the Treu and Glauben provision of the German Civil Code.[69] Good faith, introduced in the U.C.C., has later reached a national importance in doctrine and in practice. However, it should be mentioned that a few states (notably, New York and California) had recognized good faith before the adoption of the U.C.C.[70]

The U.C.C. refers to good faith in at least 54 of its 400 sections, and it is specifically referred to in each of its nine substantive articles. Section 1-201(19) gives a general definition of good faith, applicable to the entire U.C.C.:

> 'Good faith' means honesty in fact in the conduct or transaction concerned.[71]

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[69] Article 242 of the BGB.

[70] E.A. Farnsworth, ***supra*** note 43 at 667.

[71] "The 1949 draft of the U.C.C. imposed an objective obligation of good faith applicable to all contracts and dealings within the Code: "Unless otherwise agreed, in this Act... 'Good faith' means honesty in fact in the conduct or transaction concerned. Good faith includes good faith toward all prior parties and observance by a person of the reasonable commercial standards of any business or trade in which he is engaged."
"In 1950, the committee on the Proposed Commercial Code of the section on Corporation, Banking and Business Law of the American Bar Association recommended that the general definition of good faith should be restricted to the subjective duty of honesty in fact. The committee reasoned that the average businessman or lawyer would define good faith as honesty in fact rather than commercial reasonableness. The drafters of the Code followed the committee's recommendations, removing the latter portion of the draft provision in 1952, and leaving the present definition of good faith set forth in section 1-201(19): " 'Good faith' means honesty in fact in the conduct or transaction concerned. U.C.C. 1-201(19)(1989). This subjective obligation of good faith was made applicable to contracts and duties within the U.C.C. by section 1-203. Although some sections of the U.C.C. make an objective obligation of good faith applicable in certain situations, the general requirement remains that the parties behave honestly in fact."
N.W. Palmieri, ***supra*** note 33 at 92-94.

For example, the following sections from the U.C.C. refer to good faith: three sections from Article 1 on general provisions (1-201(19), 1-203, 1-208); 14 sections from Article 2 on sales (2-103(1)(b),2-305(2), 2-306(1), 2-311(1), 2-323(2)(b), 2-328(4), 2-402(2), 2-403(1),2-506(2), 2-603(3), 2-615(a), 2-706(1), 2-706(5), 2-712(1)).

But it emerges from the various dispositions related to good faith that its application is limited to the phase of contract performance.[72] The duty of good faith in the pre-contractual stage of transactions is not explicitly addressed in the U.C.C.

However, this does not mean that a duty of good faith and fair dealing in pre-contractual negotiations does not exist. In a general way, the U.C.C. recognizes that parties must perform their contracts in good faith. Such generality demonstrates that standards of good faith and fair dealing should measure all dealings, even those of a pre-contractual nature.[73]

During the last few years, courts have admitted that the duty of good faith and fair dealing existed at the negotiation stage of the contract, at least as a principle encouraging mutual confidence between the parties.[74]

But in general, American courts tend to be reluctant to explicitly apply a general duty of good faith and fair dealing to the pre-contractual stage. Bargaining and bluffing are common strategies and tactics that rule the negotiations.[75] Therefore, the only way to impose a duty of good faith in the pre-contractual stage is the conclusion of a valid

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[72] The section 1-203 provides that: "every contract or duty within this Act imposes an obligation of good faith in its performance."

[73] See. N.W. Palmieri. ***supra*** note 33 at 90-91.

[74] One court has explicitly held that there was a duty of good faith during negotiations. In that case the court stated that because Section 1-201(19) of the U.C.C. defined good faith in terms of conduct or transaction. the duty of good faith was also required in precontractual dealings. notwithstanding the language in code section 1-203.
Connecticut Nat'l Bank v. Anderson. No. 0053810. 1991 WL 204359 (Conn. Super. Ct. Oct. 1. 1991).
See. E.A. Farnsworth. ***supra*** note 54 at 60.

[75] See. V.Kusuda-Smick. eds. *United States/Japan commercial law and trade*. (Ardsley-on-Hudson. NY: Transnational Juris publications. Inc.. 1990). at 668.

preliminary agreement to negotiate in good faith. The parties must conclude a formal agreement stating the terms of pre-contractual duties.[76]

Because of the presence of ethical standards such as "course of dealing,"[77] "usage,"[78] "good faith,"[79] "fair dealing,"[80] and "honesty in fact"[81] in the U.C.C., courts and lawyers became familiar with using flexible and contextual terms.[82] The emergence of such equitable concepts, also demonstrates that contract law considers that parties cannot be perfectly equal in terms of knowledge, experience and natural ability to negotiate.[83] It also reflects a reaction of the changing nature of today's exchanges.[84] Some American courts[85] have referred to good faith in a very activist way: "as an independent source of obligation,

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[76] J. Klein and C. Bachechi, ***supra*** note 7 at 16.
See, Part II. C. The legal impact of the principle of good faith in preliminary agreement.

[77] See ***e.g.***, U.C.C. 1-205(3).

[78] See ***e.g.***, U.C.C. 1-102(2)(b) and 1-205.

[79] See ***e.g.***, U.C.C. 1-201(19), 1-203.

[80] See ***e.g.***, U.C.C. 2-103(1)(b).

[81] See ***e.g.***, U.C.C. 1-201(19) and 2-103(1)(b).

[82] G.R. Shell, "Substituting Ethical Standards for Common Law Rules in Commercial Cases: an Emerging Trend", (1988) 82 Nw. U.L. Rev. 1198, at 1204.

[83] See ***e.g.***, *Goodwin v. Agassiz*, 186 N.E. 659, 661 (Mass. 1993).
See, N.W. Palmieri, ***supra*** note 33 at 106-107.

[84] See, L.A. DiMatteo, "The Norms of Contract: The Fairness Inquiry and the Law of Satisfaction: A Nonunified Theory", (1995) 24 Hofstra L. Rev. 349, at 368.

[85] See ***e.g.***, *Kirke La Shelle Co.* v. *Paul Armstrong Co.*, 188 N.E. 163 (N.Y. 1933), and *Chrysler Corp.* v. *Quimby*, 144 A.2d 123 (Del. 1958).

often to help redress market inequalities."[86] This gives substantial value to the concept of good faith.

In the United States and France, good faith and morality are increasingly being recognized as necessary ingredients for the determination of legal obligations. The duty of good faith imposed by law is gaining acceptance.[87]

Good faith in French law is a broad concept that has much more influence than the comparable provision of Article 1-203 of the U.C.C.[88]

The Common law views contract as a bargain and the civil law views contract as agreement and relationship. These historical and conceptual differences have for consequences a different approach toward good faith in the pre-contractual stage.[89]

3. A particular application of good faith in the negotiation phase: the disclosure obligation

In France and the United States, the most significant trend of the application of good faith in the negotiation process is illustrated by the obligation for the parties to communicate all information indispensable for the comprehension of the future agreement.

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[86] R.J. Mooney, "The New Conceptualism in Contract Law", (1995) 74 Or. L. Rev. 1131, at 1179.

[87] N.W.Palmieri, ***supra*** note 33 at 84-85.

[88] E.A. Farnsworth, "The 24th J.M. Tucker, Jr. Lecture in Civil Law: A Common Lawyer's view of Civilian Colleagues" (1996) 57 La. L. Rev. 227, at 234-235.

[89] R.B Lake and U.Draetta, "Letters of Intent and Precontractual Liability" (1993) 7 IBLJ 835, at 848.

Fair and exhaustive information is necessary to give a final clear consent. "The reasonable man is free because he knows, he sees, he decides and he acts".[90]

The duty to disclose has gained importance because of the development of transactions involving high technology and computer materials. A party is not necessarily aware of all technological matters.

Based on the principle of good faith, the duty to disclose has been developed by the *Cour de cassation* and by some authors, independently from the legislation. Now, the obligation to disclose some information has been introduced in the legislation for the protection of consumers.[91] Some American statutes explicitly require good faith disclosure in negotiations. For instance, the Truth in Lending Act requires that creditors make "meaningful disclosure" in consumer credit negotiations.[92]

In France, this disclosure obligation is limited. The parties do not have the obligation to disclose know-how and other technological secrets,[93] they do not have to disclose all financial or commercial information, they have to disclose determinant and relevant information for the other party to give a clear consent. The disclosure duty is not absolute. The parties must also be aware of finding information by themselves.[94]

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[90] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 18.

[91] P. Van Ommeslaghe, ***supra*** note 59 at 35.

[92] 15 U.S.C., section 1601(a) (1982).
See. G.M. Peters, "The use of lies", (1986) 48 Ohio St. L.J. 1, at 9-10.

[93] Y. Picod, "L'obligation de coopération dans l'exécution du contrat," JCP 1988.I.3318.

[94] P. Van Ommeslaghe, ***supra*** note 59 at 37.

Thus, there is a graduation in the pre-contractual duty to disclose information. It varies with the importance of the information and with the evolution of the negotiations. As long as there is no clear intention to enter into a final agreement, the parties have no obligation to disclose sensitive information.[95]

Under American law, if one party has special knowledge about material elements of the negotiated contract and if the other party does not have or cannot practically know those material elements, then the party with special knowledge has the duty to disclose that knowledge to the other.[96]

The silence of a party will be sanctioned if it constitutes a fraudulent misrepresentation. The violation of the duty to disclose can lead to damages, if the other party would have contracted but under other conditions, with the knowledge of the hidden information. The silence can also lead to the cancellation of the contract, with the possibility of damages, if the undisclosed information is so substantial that the other party would not have contracted at all.[97]

In this perspective, American negotiators have an ethical duty to disclose relevant information. In the United States, Article 4.1 of the rules promulgated by the American

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[95] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 19.

[96] E.M.Holmes, ***supra*** note 34 at 407.
This can be illustrated by the English case *Carter v. Boehm*, 3 Burr. 1095 at 1910-1911, 97 Eng. Rep. 1162 at 1164-1165, ***supra*** note 67.
" Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing to the contrary... [The rule] is adapted to such facts as vary the nature of the contract: which one privately knows, and the other is ignorant of, and has no reason to suspect."

[97] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 19.

Bar Association Commission on Evaluation of Professional Standards imposes on lawyers, who are often part of the business negotiations, a duty to disclose relevant facts:

> In the course of representing a client a lawyer shall not:
> a) knowingly make a false statement of fact or law to a third party, or
> b) knowingly fail to disclose a fact to a third party when
> (i) in the circumstances failure to make a disclosure is equivalent to making a material misrepresentation (...).[98]

4. Good faith: a flexible and evolving concept

In France and the United States, a uniform definition of the duty of good faith and fair dealing, in the context of negotiations, does not exist.

Good faith is a flexible concept and because of its vagueness, there is always a risk of arbitrariness and uncertainty.[99] For Professor Summers, by approaching the concept of good faith in term of an "excluder," it seems that it is primarily a "functional tool for judges."[100] In a similar way, Professor Burton has defined good faith as "a license for the exercise of judicial discretion."[101] Since good faith cannot be precisely defined, these authors view it as a legal fiction for judicial expansion.[102]

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[98] Rule 8 of the Professional Conduct Handbook of the Canadian Bar "imposes on a lawyer the obligation to withdraw from negotiations when it appears that its client seeks to deceive the other party by false statements or dishonest conducts."
J-M. Loncle and J-Y Trochon. ***supra*** note 11 at 21.

[99] P. Van Ommeslaghe. ***supra*** note 59 at 28.

[100] See. R. S. Summers. ***supra*** note 50 at.206.

[101] S.J. Burton. "Breach of Contract and the Common Law Duty to Perform in Good Faith". (1980) 94 Harv. L. Rev. 369. at 370.

[102] E.M.Holmes. ***supra*** note 34 at 400.

Nonetheless, this concept should remain flexible in a aim to be applied in a variety of situations, on a case-by-case basis.[103] The flexible nature of the concept of good faith allows this doctrine to achieve its goal: maintaining or creating a fair and equitable relationship between the parties.[104] Good faith aims to give flexibility to contract law. It allows to condemn certain behaviors, to moralize the contract.[105]

Morality and ethical standards generally play an important role in the formation and the application of the law.[106]

The concept of good faith reflects the code of fair play of everyday ethics that is implied in the business world.[107] It reflects what the law should be in light of the continuing introduction of ethical standards in the business world.[108]

Good faith reveals a moralization of contractual relations. This moralization is present in various areas of law. For instance, in most countries, the laws protecting consumers in a aim to establish a fair balance between contracting parties, are gaining importance.[109] Today, the law evolves to a reinforcement of moral duty and ethical standards. This is particularly true for commercial transactions.

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[103] P. Van Ommeslaghe, ***supra*** note 59 at 28.

[104] See. N.W. Palmieri, ***supra*** note 33 at 79-80.

[105] D.Tallon, ***supra*** note 42.

[106] N.W.Palmieri, ***supra*** note 33 at 84-85.

[107] R.A. Newman, ed., *The General Principles of Equity in Equity in the World's Legal Systems: A Comparative Study Dedicated to Rene Cassin*, (Brussels: Etablissements Emile Bruylant, 1973), 589, at 600-608.

[108] N.W. Palmieri, ***supra*** note 33 at 181-182.

[109] P. Jourdain, ***supra*** note 8, at 131.

Finally, the principle of good faith may also indicate a revival of morality based on religious precepts. Justice Antonin Scalia has said that the implication of good faith in contractual situations was "simply a rechristening of fundamental principles of contract law."[110]

However, it appears that, so applied, the good faith principle conflicts with the concept of freedom of contract. The parties should not be forced to enter a contractual relation if they did not want it. In the same way, an obligation should not be imposed if the parties did not clearly agree upon it. The security of commercial transactions is one of the corollaries of contractual freedom.[111]

B. The legal impact of the principle of good faith on preliminary agreements

Certain letters of intent contain an obligation to negotiate in good faith, implicitly or explicitly.

On one hand, the contract to negotiate and the contract with open terms implicitly impose on parties a duty to negotiate in good faith. On the other hand, good faith and the best efforts clause explicitly impose this duty.

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[110] *Tymeshare v. Covell*, 727 F.2d 1145, 1152 (D.C. Cir. 1984).

[111] F. Kessler and E. Fine, "Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: a Comparative Study", (1964) 77 Harv. L. Rev. 401, at 408-409.

1. The contract to negotiate and the agreement with open terms.

The contract to negotiate is a contract by which a person commits to undertake or to pursue negotiations in a aim to reach a final agreement.[112]

According to Professor Farnsworth, an agreement to negotiate imposes a general obligation of fair dealing in the course of the negotiations.[113] There are three fair dealing standards for the contract to negotiate: "(1) actual negotiations with no imposition of improper conditions; (2) disclosure of enough about parallel negotiations to give a reasonable opportunity to make competing proposals; (3) continued negotiation until impasse has been reached unless there is another justification for breaking off the negotiations." If those three requirements are respected, the conclusion of the deal with a third party does not constitute a breach of the fair dealing duty;[114] and if, despite the continuing negotiations, the parties do not reach a final contract, they will not be contractually bound.[115]

However, American courts are traditionally reluctant to admit the existence of an implied duty to negotiate in good faith because this concept is too vague to enforce and too difficult to apply. The courts are also uncertain regarding the eventual application of an appropriate remedy.[116] Some authors express the same reserve: according to Burton

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[112] J.Schmidt, ***supra*** note 16 at 201.

[113] E.A. Farnsworth, ***supra*** note 47 at 263.

[114] ***Ibid.*** at 286.

[115] ***Ibid.*** at 263.

[116] R.B.Lake and U.Draetta, ***supra*** note 89 at 840.
It is interesting to note that under English law, an "agreement to agree" which is not a priori enforceable, can bear an implied obligation to negotiate in good faith. In the case *Donwin Productions Ltd. v EMI Films Ltd.*,

and Andersen, a general duty to negotiate, without more, is too indefinite to be enforced.[117]

That is why American parties often conclude a contract to negotiate in good faith, indicating clearly their intent to introduce this duty in their negotiations.

Under French law, the obligation to negotiate is twofold: (1) undertake the discussion which is an obligation of result, and (2) conduct the negotiation in good faith which is an obligation of means.[118] Thus, the parties have to make serious propositions while negotiating, and, in general, have a positive and active attitude toward the conclusion of a final contract.[119]

The general principle is that an agreement in principle does not constitute an obligation to contract, but it does constitute an obligation to negotiate in good faith, even if it is not expressly required by the pre-agreement.[120] Thus, the parties are free to contract but are obliged to negotiate in good faith.

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the court has decided that even if such an agreement was not enforceable "[it] did not prevent the implication of an oral agreement, once a firm agreement was in contemplation, of a term that the parties would negotiate in good faith about further terms to be inserted in a written agreement."
J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 30-31.

[117] S.J. Burton and E.G Andersen, ***supra*** note 18, at 360. (citing *Pinnacle Books, Inc. v. Harlequin Enters. Ltd.*, 519 F. Supp. 118, 122 (S.D.N.Y. 1989).
In the same way, even if the parties intend to be bound, a too indefinite pre-agreement cannot be enforceable because it may have for consequences a "surprise contractual obligation that the parties never intended."
S.J. Burton and E.G Andersen, ***supra*** note 18, at 359. (quoting *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F.Supp. 491, 497 (S.D.N.Y. 1987).

[118] See, ***infra*** B. 3. The clause of best efforts.

[119] J.Schmidt, ***supra*** note 16 at 206.

[120] J.Flour and J-L Aubert, *Les Obligations. 1. L'acte juridique, 8th ed.*, (Paris: A.Colin, 1998), at 98.

A contract to negotiate makes the parties focus on the achievement of the final agreement. The commitment to negotiate has usually no financial compensation. However, a contracting party may require a clause of exclusivity in return.[121]

It is admitted, under American and French law, that an agreement with open terms imposes two obligations: first the parties have to respect and execute the deal even if no agreement has been found on the open terms. Second, it imposes a general obligation to negotiate the open terms in good faith.[122]

This contract commits the parties to "the obligation to negotiate the open issues in good faith in an attempt to reach the alternate objective within the agreed framework." It prevents the parties from (1) renouncing the deal, (2) abandoning the negotiations, or (3) insisting on conditions that do not conform to the preliminary agreement.[123]

2. The agreement to negotiate in good faith

Under French law, the parties have the obligation to behave in good faith, all along the negotiation phase. This duty is implied in the contract to negotiate, and is accepted by the courts and the doctrine. Consequently, no distinction is made between the contract to negotiate and the contract to negotiate in good faith.

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[121] J.Schmidt, ***supra*** note 16 at 206.

[122] See, E.A. Farnsworth, ***supra*** note 47 at 253.

[123] *Teachers Insurance and Annuity Association v. Tribune Co.*, ***supra*** note 117 at 498.

Under American law, there are great advantages to conclude a contract to negotiate in good faith or to include provisions concerning the obligation to negotiate in good faith. By carefully drafting a contract to negotiate, the parties have the opportunity to define their own standard of best efforts and good faith obligation. This avoids a wide and vague definition of good faith by the courts and the imposition on parties of a large conception of a good faith obligation.[124] The contract obliges the parties to respect certain standards of conduct and not to behave as they please.[125] A failure to conduct negotiation in a aim to adhere to the agreed on timetable without sufficient justification would be a violation of the general good faith obligation.[126] Above all, the contract to negotiate in good faith avoids the discussion on the existence of a duty to negotiate in good faith and obliges the courts to admit and respect it.

However, to recognize a good faith obligation, American courts make a difference between letters of intent that were contractually enforceable and the ones that were not.

In *Reprosystem v. B.V. v. SCM Corp.*,[127] an implied duty of good faith had been found in the letter of intent by the court of first level.[128] The Second Circuit reversed the decision on appeal[129] arguing that no obligation to act in good faith existed in the absence

[124] R.B.Lake and U.Draetta, ***supra*** note 1 at 233.

[125] ***Ibid.*** at 232-233.

[126] ***Ibid.*** at 184-185.

[127] *Reprosystem v. B.V. v. SCM Corp.*, 522 F. Supp. 1257 (S.D.N.Y. 1981), rev'd. 727 F. 2d 257 (2d Cir. 1984). **[hereinafter, *Reprosystem*].**

[128] ***Ibid.*** at 1279-1280.

[129] *Reprosystem*, 727 F. 2d 257 (2d Cir. 1984).

of the formation of a contract.[130] The court required that the preliminary agreement constituted an enforceable contract in order to apply a duty to negotiate in good faith. Nevertheless, in *Evans, Inc. v. Tiffany & Co.*,[131] an obligation to negotiate in good faith has been found in the preliminary document irrespective of the existence of a formal contract. The defendant was found to have breached the requirement to negotiate in good faith and the plaintiff was awarded full expectation damages.[132] The case *Arcadian Phosphates, Inc.* v. *Arcadian Corp.*,[133] involved a breach of a preliminary agreement to sell a business. The court refused to hold the agreement enforceable but nevertheless admitted that the preliminary agreement contained a promise to negotiate in good faith.[134] The preliminary agreement included the purchase price of the business, the timing and amount of the payments, the assets to be purchased, a closing date, the basis for further negotiations, and the parties' intention to "cooperate fully and work judiciously in order to expedite the closing date and consummate the sale of the business."

Channel Home Ctrs. v. *Grossman*[135] is a significant case. Channel, a retail store, had expended important amounts of money based on the promise of Goodman, the putative lessor, to negotiate only with Channel toward a final lease. A letter of intent was signed. Later Grossman decided to terminate negotiations with Channel and concluded a lease agreement with Mr. Good Buys. Channel argued that Grossman had acted in bad faith and

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[130] ***Ibid.*** at 264.

[131] *Evans, Inc. v. Tiffany & Co.*, 416 F. Supp. 224 (N.D.I 11. 1976).

[132] ***Ibid.*** at 240.

[133] *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69 (2d Cir. 1989).

[134] ***Ibid.*** at 70-71.

[135] *Channel Home Ctrs. v. Grossman*, 795 F.2d 291 (3d Cir. 1986). **[hereinafter *Channel*]**

had breached his promise. The court, however, held that the letter was not enforceable.[136] On appeal, Channel argued that the letter was a binding agreement to negotiate in good faith. To the appellees, the letter of intent was only the evidence of preliminary negotiations and was unenforceable at law. The Court of Appeal finally held that the letter of intent was a contract to negotiate in good faith; the parties had to use their best efforts and had to negotiate in good faith to achieve a formal agreement. The letter of intent was enforceable and had a legally binding effect.[137]

This case is interesting in that the letter of intent did not require expressly the parties to negotiate in good faith; the letter of intent only contained a statement providing that the parties agreed to negotiate. It should be also highlighted that, for the first time, the concept of the contract to negotiate and its enforceability[138] were recognized by a court, although American authors had contemplated it for a long time.[139] Nonetheless, the *Channel* case is not the recognition of an implied obligation to negotiate in good faith in all contracts to negotiate.

In *Feldman v. Allengheny International*,[140] the court found a letter of intent to be an agreement to negotiate in good faith but did not admit the existence of an implied duty to

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[136] **See.** E.A. Farnsworth and W.F. Young. *Contracts. Case and materials. 5th ed.* (Westbury, NY: The foundation Press. Inc., 1995) at 276-278.

[137] ***Ibid.***, at 275.

[138] *Channel*, ***supra*** note 135 at 299.
See also, Chapter III. The enforceability of preliminary agreements.

[139] R.B.Lake and U.Draetta, ***supra*** note 89 at 842.
The question of the enforceability of the contract to negotiate or the contract to bargain has been analyzed by Professor Knapp in his article: "Enforcing the Contract to Bargain."
C.L.Knapp, ***supra*** note 15, 673.

[140] *Feldman v. Allengheny International*, 850 F.2d 1217 (7th Cir. 1988).

negotiate in good faith. The letter of intent only required that the parties negotiate exclusively with each other.[141] In *A/S Apothekernes Laboratorium v. I.M.C.Chem. Group*, the court held that the terms of a letter of intent could impose upon the parties an obligation to negotiate in good faith.[142]

The current trend is the recognition of a good faith duty in letters of intent that do not necessarily constitute an enforceable contract. However the parties must have agreed upon such an obligation, explicitly or implicitly.

3. The clause of best efforts

"Best endeavours", "best of his ability" and in French "*tout en son pouvoir*", "*au mieux de son experience*" are equivalent expressions of "best efforts", and are deemed to have the same implications and consequences.[143]

Most of time, provisions contain an obligation to negotiate in good faith and to use best efforts to reach a final agreement.[144] However, Professor Farnsworth has distinguished the standard of good faith from the standard of best efforts as follows: "Good faith is a standard that has honesty and fairness at its core and that is imposed on every party to a contract. Best effort is a standard that has diligence as its essence and is imposed only on those contracting parties that have undertaken such performance." The

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[141] ***Ibid.*** at 1219.

[142] *A/S Apothekernes Laboratorium v. I.M.C.Chem. Group*, 873 F.2d 155, 158 (7th Cir. 1989)

[143] M.Fontaine, *Droit des Contrats Internationaux. Analyse et Rédaction des Clauses*, (FEC: Paris, 1989), at 105.

standard of best efforts is more precise.[145] In *Thompson v. Liquichimica of America, Inc.*, the court stated that: "an agreement to use best efforts is a closed proposition, discrete and actionable. Such an agreement does not require that the agreement sought be achieved, but does require that the parties work to achieve it actively and in good faith."[146] In many cases, American courts have admitted the existence, in preliminary agreements, of an obligation to use best efforts to reach a final agreement, even if it was not explicitly specified.[147]

In French law, it is an obligation of means,[148] *i.e.*, an obligation to act in a certain way and not an obligation of result,[149] *i.e.*, an obligation to achieve a certain result. A party who has an obligation of means has the duty to use every appropriate mean in a aim to reach a given result, without promising that she will effectively achieve it. This party may be held liable if the other party demonstrates that she has not used every possible mean, that she did not act with enough diligence. The question at stake is what enough diligence is. For a long time, the diligence has been appreciated by looking at an abstract model: the

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[144] R.B.Lake and U.Draetta, ***supra*** note 1 at 10.

[145] E.A.Farnsworth, "On Trying to Keep One's Promise: The Duty of Best Efforts in Contract Law", (1984) 46 U.Pitt.L.Rev. 1, at 8.

[146] *Thompson v. Liquichimica of America, Inc.* 481 F. Supp. At 366.

[147] See ***e.g.***, *Arnold Palmer Golf Co. v. Fuqua Indus.*, Inc., 541 F.2d 584, 588 (6th Cir. 1976).

[148] In French "*Obligation de moyens.*"

[149] In French "*Obligation de résultat.*"
In this case, the purpose of the obligation is strictly defined. The party has promised to reach a given result. If the result is not achieved, this failure constitutes a breach of duty and the party is automatically contractually liable. However, she has the possibility to plead force majeure.

reasonable man ("*le bon père de famille*"). Today, the reasonable man is defined as a shrewd and circumspect person of the same profession.[150]

Under American law, when the promisor possesses a special skill, courts refer to a third person with this special skill and ask what efforts this person would use if he were the promisor.[151]

The French concept of appropriate means can be considered as the counterpart of the American concept of best efforts.[152]

Letters of intent that organize schedules of negotiations often contain a best effort clause to reach an agreement on given points with respect to the timetable. This obligation translates into an obligation of co-operation.[153]

Like the standard of good faith, the standard of best efforts may be used by the courts to identify the existence of a breach of obligation. For instance, a party cannot be held liable if, despite her efforts to reach a final contract, those efforts have been unsuccessful.[154]

Letters of intent containing "best efforts" or "due diligence" clauses are common. This requirement of a fair conduct may be analysed as a "natural" presence of ethic within

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[150] P.Malaurie and L.Aynès, *Droit civil. Les Obligations., 8th ed.* (Paris: ed.Cujas, 1998), at 466.

[151] E.A. Farnsworth, ***supra*** note 145 at 9.

[152] ***Ibid.*** at 4.

[153] R.B.Lake and U.Draetta, ***supra*** note 1 at 184.

[154] E.A. Farnsworth, ***supra*** note 145 at 13-20.

the business world or, on the contrary, as a necessary compensation for the loss of moral values and a necessary threat of sanction in case of non respect.[155]

Letters of intent play a key role in imposing an obligation to act in good faith during the negotiation phase.[156]

[155] J-M. Loncle and J-Y Trochon. ***supra*** note 11 at 9.

[156] ***Ibid.*** at 11.

Chapter III. The enforceability of preliminary agreements

The main issue raised by letters of intent is to determine if the parties are still in the pre-contractual phase, or if it can be considered that a valid contract has been concluded, *i.e.*, if the letter is exhaustive enough to constitute a valid contract. This issue arises because of the vagueness of the terms employed in the pre-agreements. Lawyers are not systematically involved in the drafting of letters of intent and business people are not always aware of the legal implications of this signed document.[157] Lawyers and business people have a different view on the legal nature of letters of intent. For commercial reasons, business people tend to perform naturally their obligations, without minding of the enforceability of the letter. They feel morally bound by the pre-contractual agreement.

A. Preliminary agreements and the rules of contract formation

1. Contract formation in French and American law

Under French law, the essence of contract law is the theory of the autonomy of will. According to this theory, Man, being innately free, can be bound only by his own will. This will, which is independent from the law, creates the effects of the contract and

[157] See. R.B.Lake and U.Draetta. *supra* note 1 at 10.

sovereignly determine its content. These legal effects exist only because they have been wanted and in the way they have been wanted by the Man.[158]

A definition of contract is given by Article 1101 of the French Civil Code: "A contract is a convention by which one or more persons obligate themselves, toward one or more others, to give, to do, or not do something."[159] Thus, a contract is the result of an agreement between the parties. The parties have to reach a meeting of minds upon the essential elements of the supposed contract. Such a meeting of minds consists, in principle, of "a meeting of two unilateral acts of will: an offer to conclude the said contract and the acceptance of this offer."[160] The "meeting of minds" is necessary and sufficient to make a contract. Meeting of minds can be translated into manifestation of mutual assent.[161]

The offer must be firm and precise enough to be accepted immediately. The Civil Code does not require specific forms of acceptance but it must not be ambiguous. Therefore, silence cannot imply acceptance. However, silence may be admitted as a form of acceptance under specific circumstances.[162] The existence of prior business relations between the parties may constitute a specific circumstance to accept silence as a mean of

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[158] J.Ghestin, *supra* note 63 at 27.

[159] Article 1101 of the civil Code: "le contrat est une convention par laquelle une ou plusieurs personnes s'obligent, envers une ou plusieurs autres, à donner, à faire ou à ne pas faire quelque chose."

[160] J. Schmidt-Szalewski, *Formation of contracts and Precontractual liability*, (Paris: ICC Publishing S.A., 1990) at 91.

[161] E.M.Holmes, *supra* note 34 at 404.

[162] J. Schmidt-Szalewski, *supra* note 160 at 92.

acceptance.[163] An old jurisprudence admits that silence constitutes acceptance when the offer is made for the exclusive advantage of the offeree.[164]

Under American law, the notion of "consideration" is a major element of contract formation. Consideration is defined by the Restatement Second of Contracts (hereinafter the "Restatement Second") as follows: it is "an act, or a forbearance, or a return promise, bargained for or given in exchange for the promise."[165] Consideration is at the heart of the conception of common law contract. The contract is seen as a bargain.[166] In contract formation, the relation between consideration and intention is a close one. Both have an important role in defining promises that the law enforces and the ones that are not enforceable.

The formation of an express contract requires an offer and the acceptance of this offer. Acceptance must be clear and without ambiguity. Consequently, silence or inaction by the offeree cannot create contractual obligation.[167] However, under some

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[163] Cass.civ.I. March 20, 1984, Bull.I.n. 106.

[164] Cass.req., March 29, 1938, S. 1938, 1, 380; D.P. 1939, 1, 5, note Voirin.

[165] Restatement (Second) of Contract section 90 (1981).

[166] "Under the concept as defined in the Restatement, a promisor must intend that the promise induce the promisee to give the return consideration. The common law requirement of consideration does not require that courts consider the quantum or adequacy of the consideration given."
R.B.Lake and U.Draetta, ***supra*** note 1 at 37.

[167] "If you propose going to see a particular film this weekend and I do not answer, you cannot construe my silence as acceptance. At best, my silence indicates that I have not made up my mind; unless I inform you later that I would like to join you, you can infer that I will not be attending. To be exact, my silence in this situation is not directly a rejection of your offer, but it effectively operates as such. Out of politeness, I do not want to turn down your proposal in so many words. Instead, I do not respond, allowing you to infer that I do not wish to see the film with you, because, if I did want to join you, I would have accepted your proposal. This is the basic rule in the law of contracts as well. As phrased by Corbin, "it is an old maxim that silence gives consent, but this is not a rule of law"."
P. Tiersma, "The Language of Silence," (1995) 48 Rutgers L. Rev. 1, at 25.

circumstances, silence or inaction can create contractual obligations. The Restatement Second provides that "because of previous dealings or otherwise, it is reasonable that the offeree should notify the offeror if he does not intend to accept."[168] The analysis of parties' behaviour in the past can determine if acceptance has been given. Course of dealings between parties, usage, previous commercial transactions constitute evidences to deduce acceptance from silence or inaction.[169]

In French contract law, and in the civil law systems in general, consideration, in its common law sense, does not exist. A proper *cause* is necessary to enforce a promise.[170] An immoral cause cannot constitute the basis of a promise.[171] Common law is only concerned by the existence of a legal detriment and a bargain. The adequacy and the fairness of the consideration is theoretically not questioned.

However, the French legal notion of *cause* is close to the common law notion of consideration. A *cause* consists "in an immediate economic counterpart, a service received in the past, any economic interest, or even a moral interest of the debtor." The notion of cause is broader than the notion of consideration, which basically consists of an economic counterpart.[172]

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[168] Restatement (Second) of Contracts section 69(1)(c) (1986).

[169] P. Tiersma, *supra* note 167 at 26.

[170] Article 1131 of the civil code: "L'obligation sans cause, ou sur une fausse cause, ou sur une cause illicite, ne peut voir aucun effet."

[171] Article 1133 of the civil code: "La cause est illicite, quand elle est prohibée par la loi, quand elle est contraire aux bonnes mœurs ou à l'ordre public."

[172] J. Schmidt-Szalewski, *supra* note 160 at 93.

The classical contract doctrine is primarily concerned with determining when parties have reached an agreement and what obligations have arisen.[173] American and French law of contract formation are characterized by the fulfilment of express formalities. Those requirements are clear and precise, and it seems that there can be no contract without the fulfilment of such formalities.

2. The inadequacy of the classical rules of contract formation for the issue of preliminary agreements.

Neither American law nor French law considers the legal implications of letters of intent. This can be explained by the hybrid and numerous forms of letters of intent . It can also be explained by the origins of the rules of contract formation in French and American contract law. Initially, the classical rules of contract formation contemplated contracts that contained obligations to be fulfilled immediately.[174]

The Civil Code, the Restatement Second or the American Uniform Commercial Code do not rule the negotiation process. The negotiations are conducted freely by the parties.

The pre-contractual process traditionally consists of an exchange of proposals and counterproposals relating to the elements of the contract. Under French law, the consent is necessary and, in principle, sufficient for the formation of a contract.[175] Under American

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[173] M.D. Rosen, "What Has Happened To The Common Law ? Recent American Codifications, and Their Impact on Judicial Practice and the Law's Subsequent Development," (1994) Wis. L. Rev. 1119, at 1239-1240.

[174] R.B.Lake and U.Draetta, ***supra*** note 1 at 18.

[175] J.Schmidt-Szalewski, ***supra*** note 20 at 147-148.

law, if the parties have reached an agreement on substantial points of the letter of intent, it is sufficient for the formation of a formal contract.

French law is less demanding concerning the proof of preliminary agreements than American law. French judges will likely privilege the enforceability of such documents because common sense presumes that business people sign agreements in an aim to create binding obligations and not to create meaningless instruments. Thus, informal, partial and even oral promises can be declared enforceable by the French judge. Article 109 of the French Commercial Code states that "with respect to merchants, acts of commerce may be proved by all means."[176] Traditionally, the common law does not accept that a party could be involuntarily bound by an agreement. The most important point is the intent of the parties.[177]

Consequently, French judges are more likely to declare the parties legally bound at an earlier stage of the negotiation process than courts in common law countries. According to Klein and Bachechi "the civil law concept of contract focuses on the relationship between the parties. The formal contract is not the dramatic event in civil law countries that it is in common law countries."[178]

In an article of 1992, Professor Tiersma has suggested to tackle the issue of complex transactions by focussing on the concept of commitment rather than considering offer and

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[176] Article 109 of the French Commercial Code: "A l'égard des commerçants, les actes de commerce peuvent se prouver par tous moyens à moins qu'il n'en soit autrement disposé par la loi."
L.A. DiMatteo, ***supra*** note 40 at 71-72.

[177] J. Klein and C. Bachechi, ***supra*** note 7 at 6.

[178] R.B.Lake, ***supra*** note 13 at 342.
"Civil law jurisdictions have historically proven more receptive to claims based upon precontractual liability."

acceptance. According to Professor Tiersma, a complete proposal is made all along the negotiation process, through the exchange of various documents. Although it may be impossible to clearly define when an offer has been made and when it has been accepted, it is clear that a commitment exists. In Professor Tiersma's words "what is therefore critical to the formation of a contract is not specifically offer and acceptance, or even agreement, but some act of commitment."[179]

Therefore, a preliminary agreement may be of a pre-contractual nature or of a contractual nature. It depends on the wording used in the pre-agreement and of the behaviors of the parties. In case of ambiguity, the French and American judges determine whether the parties have intended to be bound or not.[180]

The rules of offer and acceptance are not in question in the issue of preliminary agreements. The main issue at stake is the interpretation of the parties' will and the determination of their possible intent to be bound by the pre-agreement.[181]

B. The interpretation of the common will of the parties

It may sometimes be difficult to determine the intention of the parties. To define the parties' intentions, the French and American judges will interpret the parties' will

[179] P. M. Tiersma. "Reassessing Unilateral Contracts: The Role of Offer. Acceptance and Promise" (1992) 26 U.C.Davis L.Rev. 1. at 41.

[180] See. *infra* Chapter III. The enforceability of preliminary agreements.

[181] See. E.A. Farnsworth. *supra* note 47 at 250.

expressed in the agreement, as well as the circumstances of the conclusion of the preliminary agreement.[182] The intention of the parties is at the key element to determine if a pre-contractual document is legally binding.

The issue of interpretation is not peculiar to contract law. A statute, a regulation or a will, for instance, may also be concerned. The peculiar issue for the interpretation of a contract is that it involves two parties who may attach different meanings to language.[183]

To determine the intentions of the parties, the American and the French methods differ.

1. The subjective and objective theories

In France, contract law focuses on the relationships of the parties. According to Article 1156 of the Civil Code,[184] the judge has to look, in the convention, for the common intention of the contracting parties, rather than concentrating on the literal meaning of the terms. According to Domat: "if the terms of a convention appear to be the contrary of the obvious intention of the parties, this intention, rather than the terms, has to be respected."[185] Thus, the French judge has to discover the real will of the parties, the spirit of their relationship that is not necessarily revealed by the words used in the agreement. He has to consider their subjective intention. Their writings or other external

[182] E.A. Farnsworth and W.F. Young, ***supra*** note 136, at 277.

[183] ***Ibid.*** at 582-583.

[184] Article 1156: "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."

[185] See, J.Domat, *Les lois civiles dans leur ordre naturel*, Livre I, titre I, Section II, no.43, (Luxembourg: André Chevalier, 1702).

manifestations of intention are secondary.[186] The judge has to look for the common intention of the parties because the contract has been drafted by them.

Demolombe, a French legal scholar, said on contract interpretation that: "the contract being the result of the common will of the contracting parties, its consequences should be determined in accordance with this common will. This is the aim of the interpretation and not one of its means. Interpretation always aims to discover what the parties have really wanted."[187]

The American judge has an objective approach. He has to consider the meaning of the words and the external manifestations of the parties' intention, *i.e.*, the objective intention. According to the objective theory, the meaning attached to the language by the parties has no importance. The meaning is defined in accordance with objective standards. Consequently, it can be different from the one of the parties.[188]

The objective and subjective doctrines are well described by Judge Learned Hand and Judge Jerome Frank.[189] According to Hand: "A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent. If, however, it were proved by twenty bishops that either party when he used the words intended something else than the usual

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[186] R.B.Lake and U.Draetta, ***supra*** note 1 at 38.

[187] C.Demolombe, *Cours de Code Napoléon, Tome II. Traité des Contrats ou des Obligations Conventionnelles en général*, (Paris, Auguste Durand, 1860) at 4.

[188] E.A. Farnsworth and W.F. Young, ***supra*** note 136 at 591.

[189] ***Ibid.***

meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake or something else of the sort."[190] According to Frank: "In the early days of this century a struggle went on between the respective proponents of two theories of contracts, (a) the "actual intent" theory or "meeting of the minds" or "will" theory, and (b) the so-called "objective" theory. Without doubt, the first theory had been carried too far: Once a contract has been validly made, the courts attach legal consequences of which the parties usually never dreamed, as for instance, where situations arise which the parties had not contemplated. As to such matters, the "actual intent" theory induced much fictional discourse which imputed to the parties intentions they plainly did not have. But the objectivists also went too far. They tried (1) to treat virtually all the varieties of contractual arrangements in the same way, and (2), as to all contracts in all their phases, to exclude, as legally irrelevant, consideration of the actual intention of the parties or either of them, as distinguished from the outward manifestation of that intention. At any rate, the sponsors of complete "objectivity" in contracts largely won out in the wider generalizations of the Restatement of Contracts and in some judicial pronouncements."[191]

The influence of the objective and subjective theories in contract formation is illustrated by the Restatement First and the Restatement Second.

The Restatement First of Contracts reflects the position of Williston who prefers an objective approach of contract interpretation: the expectations or the understanding of a reasonable person is considered.[192] The use of an objective standard allows the court,

[190] *Hotchkiss v. National City Bank of New York*, 200 F. 287 (S.D.N.Y.1911).

[191] *Ricketts v. Pennsylvania R. Co.*, 153 F.2d 757 (2d Cir.1946).

[192] Restatement, First, section 230:
"The standard of interpretation of an integration, except where it produces an ambiguous result, or is excluded

rather than the jury, to interpret the contract. This is a mean to lessen the uncertainty in contract interpretation.[193]

On the other hand, Corbin has a subjective approach of contract interpretation: the first step is to determine what the parties have subjectively intended. His opinion has been taken into account in the Restatement Second.[194] The subjective meaning or understanding of the parties is considered in priority and this is a factual issue left to the concern of a jury. This approach has the virtue of enforcing a contract that reflects the real intention and expectations of the parties, regardless of certainty and efficiency.[195]

Finally, the application of the subjective theory and of the objective theory likely leads to the same consequences. Both theories aim to discover parties' intention. There are great probabilities that a meaning given by a reasonable person to some circumstances and what the parties really mean are actually the same. The only distinction is the taking of evidence.

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by a rule of law establishing a definite meaning, is the meaning that would be attached to the integration by a reasonably intelligent person acquainted with all operative usages and knowing all the circumstances prior to and contemporaneous with the making of the interpretation, other than oral statements by the parties of what they intended it to mean."

[193] C.D.Rohwer and G.D.Shaber eds., *Contract in a nutshell*, 3rd edition, (St Paul, Minn.: West Publishing co., 1990), at 150. **[hereinafter *Contract in a nutshell*, 3rd ed.]**.

[194] Restatement, Second, section 201: "
(1) Where parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning.
(2) Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made
(a) that party did not know of any different meaning attached by the other, and the other knew the meaning attached by the first party; or
(b) that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party.
(3) Except as stated in this Section, neither party is bound by the meaning attached by the other, even though the result may be a failure of mutual assent."

Besides, the French subjective concept is not absolute. The *Cour de cassation* has developed the doctrine of the "clear and precise clauses": the lower courts must not inquire into the subjective intention of the parties when the meaning of a writing is clear and precise.[196]

2. The use of external criteria

In France and in the United States, the judge may use pre-contractual documentation to determine in what extent the parties have intended to be bound by the provisions contained in preliminary agreements.[197] The surrounding facts and circumstances also serve to enlighten the parties' will.

The American judge can take into account all correspondence, prior transactions, custom and usage in trade,[198] and any prior course of dealing[199] between the parties.[200]

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[195] *Contract in a nutshell*, 3rd ed., ***supra*** note 193 at 153-154.

[196] R.B.Lake and U.Draetta, ***supra*** note 1 at 41.

[197] See. R.B. Lake and U. Draetta, ***supra*** note 1 at 26.

[198] The section 1-205(2) of the U.C.C. defines "usage of trade" as "any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question." Usage of trade reflects community practices.
"Under such designations as "custom", "custom and usage" or "usage of the trade", common law courts have recognized the necessity of learning how people usually talk and what they usually mean by their language before one interprets their contracts."
Contract in a nutshell, 3rd ed., ***supra*** note 193 at 160.

[199] The section 1-205(1) defines "course of dealing" as "a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct."
A private usage of trade of the parties is considered and allows to determine what they really mean in their transactions. An established course of dealing will prevail upon a usage of trade if both are in conflict.
Ibid. at 162.

Thus, despite the importance of the statute of frauds, the American courts have used good faith, commercial practice and other objective standards to enforce informal contracts such as preliminary agreements. Professor DiMatteo has noted that: "The finding of an agreement should not be frustrated where it is possible to reach a fair and just result."[201]

To define the intentions of the parties, American courts have also to look at the relevant external manifestations of their intention. Besides, the language expressly used in the agreement, the judge can consider the other correspondence and documentation, and the actions of the parties.[202]

The French judge can also refer to other criteria, like good faith, equity and usage, whenever the common will appears to be diverging.[203]

Two American judges have highlighted the difficulty to interpret the parties' intention during the negotiation process.

In *United States* v. *Braunstein*,[204] Judge Medina remarked: "It is true that there is much room for interpretation once the parties are inside the framework of a contract, but it seems that there is less in the field of offer and acceptance. Greater precision of expression may be required, and less help from the court given, when the parties are

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[200] C.D.Rohwer and G.D.Shaber eds. *Contract in a nutshell*, 4th edition. (St Paul. Minn.: West Publishing co., 1997), at 11. **[hereinafter. *Contract in a nutshell*, 4th ed.]**.

[201] L.A.DiMatteo. ***supra*** note 40 at 102.

[202] *Cox Broadcasting Corp. v. National Collegiate Athletic Ass'n*. 250 Ga. 391. 297 S.E.2d 733 (1982).

[203] J.Ghestin. *Les Obligations. Les Effets du Contrat*.. (LGDJ: Paris. 1992). at 8-9.

[204] *United States* v. *Braunstein*. 75 F.Supp. 137 (S.D.N.Y.1947).

merely at the threshold of a contract." In *Henry Simons Lumber Co.* v. *Simons*,[205] another judge said: "Because of strict rules governing offer and acceptance, which require that an acceptance be in terms of the offer, we are reluctant to follow by analogy rules laid down with respect to contracts already formed. In passing upon questions of offer and acceptance, courts may wisely require greater exactitude than when they are trying to salvage an existing contract. Where no contract has been completed and neither party has acted to his detriment, there is no compulsion on a court to guess at what the parties intended."

The existence of preliminary documents may serve as evidence to determine if a contract exits between the parties. But basically the judge will have to highlight the real intention of the parties.[206]

The issue of the existence of a binding contract is a question of fact, left to the discretion of the court. The American and the French judges play a key role in determining if, during the negotiations, the parties have reached an agreement that could be considered to be enforceable. They make a case-by-case interpretation. Thus, arbitrary decisions and unequal treatments of similar cases characterize the approach of this issue by the French and American courts.

Judges may be tempted to favor contractual justice rather than contractual freedom, *i.e.*, to introduce their own standard of fairness to decide if the parties are bound or not by an agreement. The interpretation of the intent of the parties can be, doubtless, influenced

[205] *Henry Simons Lumber Co.* v. *Simons*, 44 N.W.2d 726 (Minn.1950).

[206] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 29.

by the judge's conceptions on policy, welfare, justice, right and wrong, "such notions often being inarticulate and subconscious".[207]

Taking into account the evolution of contract formation, Professor Atiyah has noticed the growing influence of contractual justice in courts. According to him, courts used to enforce the will of the parties in a aim to effectively realize their intention. Now, courts justify their refusal to enforce promises by stating that the parties did not intend to create legal relations by their promises, which "appears to be merely a legal justification for refusing to enforce a promise which the courts think, for one reason or another, it is unjust or impolitic to enforce."[208]

This situation creates uncertainty for, at least, one of the parties that may face tremendous damages for the breach of a document that she has never considered as a binding contract. The court should respect the economic interest in the successful negotiation of contracts and the preservation of the contractual freedom.[209]

[207] A.L.Corbin, "Offer and Acceptance, and Some of the Resulting Legal Relations", 26 (1917) Yale L.J.169, at 206.

[208] P.Atiyah, *Consideration, A Restatement*, in *Essays On Contract*, (Oxford: Clarendon Press, 1986), at 184.

[209] M.Furmston, T.Norisada, J.Poole, *Contract Formation and Letter of Intent*, (John Wiley and Sons Ltd: Chicheste, West Sussex, 1998).

C. The legal implication of the wording used in the preliminary agreement

In the process of determining whether the parties have entered into a contractual relationship, the language used by the parties is a key element. The legal force of a letter depends mainly on the precision of its wording.

The obligations of the parties result from the wording of their preliminary agreement and also from their further behaviors and actions.[210]

1. The issue of definiteness

Letters of intent and any other pre-contractual elements can serve as evidence of the existence of an agreement between the parties, on the condition that the terms are clear and precise enough to demonstrate that the parties are bound by an obligation.

If the language of the letter of intent is clear, the French and American judges will respect it.

a) The consideration of the unequivocal language of the letter of intent

In *Terracom Development Group, Inc.* v. *Coleman Cable & Wire Co.*,[211] the letter of intent contained the following statement: "This letter of intent is expressly conditioned

[210] R.B.Lake and U.Draetta, ***supra*** note 1 at 5.

upon our entering into a mutually satisfactory definitive written agreement in the form satisfactory to our counsel." In accordance with the unambiguous language of the letter of intent, the court held that the preliminary agreement was not legally enforceable.

In a case in 1987,[212] the *Cour de Cassation* decided that a compulsory obligation could be found in a preliminary agreement on the condition that the purpose of this obligation was clear and precise.[213] On the contrary, a French court has decided that a document providing that: "this contract is the general legal framework identifying the basic terms which should govern the co-operation between the parties," did not have a binding effect.[214] In a case in 1991, the *Cour de cassation* held that a preliminary agreement could not be enforced because the drafter of the letter of intent had specified that the subsequent authorization of the executive board was necessary. Subsequently, the executive board had disapproved.[215]

The wording used by the parties in the preliminary agreement may indicate that an operative assent has not yet been given and that further actions are needed to reach a final contract.[216]

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[211] *Terracom Development Group. Inc.* v. *Coleman Cable & Wire Co.* 50 Ill. App. 3d 739. 365 N.E.2d 1028 (1977).

[212] Cass.com.. 28 April 1987. Rev. Sociétés 1988.

[213] J-M. Loncle and J-Y Trochon. ***supra*** note 11 at 10.

[214] ***Ibid.*** at 30-31.

[215] Cass.com. J.C.P. 1991. I. no.104.

[216] A.L.Corbin. revised edition by J.M.Perillo. *Corbin On Contracts. Vol.1 Formation of Contracts.* (St Paul. Minn.: West Publishing. 1993) at 101.

Concerning a letter of intent contemplating a future agreement, the French courts have the same position as the American courts. If the parties have expressly indicated that the letter of intent is subject to the execution of a formal contract, the court will respect their will.[217]

In the case *SA Banque Rhône Alpes v. Dumez France*, the *Cour de cassation* considered that the consent was not perfectly formed because one party had claimed, since the beginning, for the requirement of a definitive and detailed document.[218] In *Arcadian Phosphates Inc. v. Arcadian Corp.*,[219] the American judge examined the language used in the memorandum and discovered that two provisions referred to the eventuality of failed negotiations and contemplated the issue of expenditures occurred during the negotiations. The memorandum also referred to a binding agreement to be completed in the future. The court then decided that no binding agreement had been reached.

When a letter of intent contains a clear statement that the parties do not intend to be bound, the judges will preclude the creation of an enforceable contract.

Contract law aims to protect the parties' reasonable expectations. If neither party intends or wants to be bound, the preliminary agreement should not be enforced.[220] This is confirmed by the comment a of Section 27 of the Restatement Second: "if either party knows or has reason to know that the other party regards the agreement as incomplete

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[217] R.B.Lake, ***supra*** note 13 at 342.

[218] Cass.com., April 28 1994, 3 (1995) RJDA no.264.

[219] *Arcadian Phosphates Inc. v. Arcadian Corp.*, ***supra*** note 133.

[220] See, *Contract in a nutshell*, 4th ed., ***supra*** note 200 at 11.
However, in *Smith v. Onyx Oil & Chemical Co.*, the defendant has been found to be bound by the agreement despite his reneging and repudiating.
Smith v. Onyx Oil & Chemical Co. 218 F.2d 104, 50 A.L.R.2d 216 (3d Cir.1955).

and intends that no obligation shall exist until other terms are assented to or until the whole has been reduced to another written form, the preliminary negotiations and agreements do not constitute a contract."

Under French law, the parties may stipulate that the letter of intent is a non contractual document. This precision may have influence on the court in determining if the document is contractually binding. An American court has deduced that the term "letter of intent" used by the parties indicated that the document was not contractual. In *Chicago Inv. Corp. v. Dollins*, the court, referring to a document entitled letter of intent, stated that "the title of the document suggests preliminary negotiations as opposed to a final contract."[221] However, it is not the general rule.

In French law, the principle is that the preliminary agreement does not constitute the main contract unless there are provisions stating the opposite.[222] Under American law, a clear statement of the parties that a preliminary agreement has no legal effect is enforceable under American law, unless elements of bad faith are present.[223]

b) Ambiguity and misunderstanding

In the negotiation phase, each party wants to be sure that some points, contained in the letter of intent, will not be discussed again in the final agreement. Unclear letters of

[221] *Chicago Inv. Corp. v. Dollins*, 481 N.E.2d 712 (1985) at 716.

[222] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 10.

[223] R.B.Lake and U.Draetta, ***supra*** note 1 at 64.

intent are often due to divergent points of view: each party is willing, at the same time, to preserve his right to negotiate again some points, and to oblige the other party not to do so.[224]

When the language of the letter of intent is not clear, the court examines the actions and the words of the parties.

In *Frank Horton & co.* v. *Cook Electric Co.*,[225] the letter of intent contained a clause providing that some equipment was necessary. Frank Horton made substantial expenditures based on this clause. Subsequently, Cook declared that a formal contract would not be executed. Regarding the terms of the preliminary contract, the performance commenced by Horton and other various factors, the court held that a contract was formed although the letter of intent clearly stated that the parties contemplated a ultimate formal contract.

In the case *Field v. Golden Triangle Broadcasting Inc.*,[226] the letter of intent contained a "subject to contract" clause. However, the court considered the terms and the partial performance by the parties and held that the letter of intent embodied the essential terms and constituted a binding contract. The "subject to contract" clause originally aims to make the letter of intent a conditional contract. This clause is not conclusive: the nature of the letter of intent, the wording of the letter and its definiteness are factors that can be considered by the judge to admit the existence of a contract. In the case *I"Soske* v.

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[224] *Ibid.* at 10.

[225] *Frank Horton & co.* v. *Cook Electric Co.* 356 F.2d 485 (7thCir.), *cert. denied*, 384 U.S. 952 (1966).

[226] *Field v. Golden Triangle Broadcasting Inc.*, 305 A.2d 689 (1973), cert. Denied, 414 US 1158 (1974).

Barwick, the court states that: "The mere fact that the parties contemplate memorializing their agreement in a final document does not prevent their informal agreement from taking effect."[227]

An American judge[228] has recently listed two widely-accepted common law principles, indicating the classical judicial tension between the concepts "contract arises upon meeting of the minds, no binding contract absent a writing": "(a) that absent an expressed intent that no contract shall exist, mutual assent between the parties, even though oral or informal, to exchange acts or promises is sufficient to create a binding contract; (b) that to avoid the obligation of a binding contract, at least one of the parties must express an intention not to be bound until a writing is executed."

Under French law, since the relationship between the parties is one of the fundamental concepts of French contract law, a formal writing is not necessary to establish the existence of a contract. Unless the parties have clearly showed a contrary intention in their words and in their actions, contractual rights and obligations can arise from an informal contract.[229] Moreover, according to para.2 of Article 12 of the French civil procedure code,[230] the judge must give a correct legal definition to facts or acts

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[227] *V'Soske* v. *Barwick*, 404 F.2d 495, 499 (2d Cir.1968).

[228] *Consarc Corporation v. Marine Midland Bank, N.A.*, 996 F.2d 568 (2d Cir.1993).

[229] R.B.Lake, ***supra*** note 13 at 342-343.

[230] Art.12 para.2: le juge "doit donner ou restituer leur exacte qualification aux faits et aux actes litigieux sans s'arrêter à la dénomination que les parties en aurait proposée".

regardless the original denomination given by the parties. Consequently, the French judge has officially the power to legally categorize a pre-contractual document.[231]

Thus, under French and American law, the existence of a provision stating that the parties contemplate the execution of a formal contract does not preclude the creation of a legally enforceable contract.[232]

The use of unclear language in the preliminary agreement may reveal a misunderstanding between the parties. To avoid the application of a contract for which both parties have a different interpretation, it is important to define whether either party knows or has reason to know the meaning given by the party to the words and actions. In the case *Towne v. Eisner*,[233] Justice Holmes said that: "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used."

Under American law, if there is a misunderstanding, if each party knows or has reason to know that a different meaning was given to the agreement by the other, there is

[231] However, the article 12 para 4 of the French civil procedure code highlighting the principle of freedom of contract, states that the judge cannot change the nature of the contract, he is bound by the denomination given by the parties to the document. (Le juge "... ne peut changer la dénomination ou le fondement juridique lorsque les parties, en vertu d'un accord exprès et pour les droits dont elles ont la libre disposition, l'ont liés par les qualifications et points de droit auxquels elles entendent limiter le débat".)
Nonetheless, this article is controversial concerning the fact that the judge could be bound by a "non contractual" mention. According to some authors, it should be clearly mentioned in the document that this statement binds the judge.
See, 94ème Congrès des Notaires de France, ***supra*** note 24 at 30.

[232] R.B.Lake, ***supra*** note 13 at 354.

[233] *Towne v. Eisner*, 245 U.S. 418 (1918).

no mutual assent in accordance with Section 20 of the Restatement.[234] In accordance with comment a of Section 26 of the Second Restatement: " 'Reason to know' depends not only on the words or other conduct, but also on the circumstances, including the previous communications of the parties and the usage of their community or line of business."[235]

Under French law, when a party has, in good faith, an erroneous interpretation of the intention of the opposite side, the party's intention is the one understood, in good faith, by the opposite side.[236]

American courts distinguish according to the ability and capacity of the contracting parties. In the case *Weiland Tool & Mfg. Co. v. Whitney*,[237] the court has interpreted an agreement against the party that was represented by a lawyer. The court assumed that the lawyer must have had the ability to express in concise and clear English the interpretation of his client and "since he did not do so, [the court] is further persuaded that this was not

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[234] (1) There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestation and
(a) neither party knows or has reason to know the meaning attached by others: or
(b) each party knows or each party has reason to know the meaning attached by other.
(2) The manifestations by the parties are operative in accordance with the meaning attached to them by one of the parties if
(a) that party does not know of any different meaning attached by the other, and the other knows the meaning attached by the first party: or
(b) that party has no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party.
(c)

[235] See, A.L.Corbin, revised edition by J.M.Perillo, ***supra*** note 216 at 107.

[236] J.Schmidt-Szalewski, ***supra*** note 20 at 155.

[237] *Weiland Tool & Mfg. Co. v. Whitney*, 251 N.E.2d 242 (Ill.1969).

his intention." The court has interpreted the contract against the party represented by a lawyer because this one is deemed to have special drafting skills.[238]

In cases of unclear letters of intent, some American courts[239] have referred to New York law to enforce preliminary agreements of intent as final contracts. This law is a four-factor test, also called the Winston test. In the case *Winston v. Medicare Entertainment Corp.*, the judge gave guidance to determine whether the parties intended to be bound before the finalization of a formal contract: The factors are: "(1) whether there has been an express reservation of the right not to be bound in the absence of a writing; (2) whether there has been partial performance of the contract; (3) whether all of the terms of the alleged contract have been agreed upon; (4) whether the agreement at issue is the type of contract that is usually committed to writing."[240]

The four-factor test has been applied in the famous case *Texaco Inc. v. Penzoil Co.* The case involved two oil companies: Penzoil and Texaco that were competing for the purchase of a third company, Getty Oil. Penzoil and Getty had concluded an agreement by which Penzoil undertook to purchase a major number of Getty's shares. The question at stake was whether this agreement in principle bound the parties. After the signing of the agreement, various entities of Getty Oil were sold to Texaco.[241] Pennzoil first attempted

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[238] This reasoning is the same for adhesion contracts. This kind of contract is interpreted against the drafter who is assumed to have not only special drafting skills, but also economical and psychological advantages over the other party. Moreover, most of time, this other party has no power to modify the provisions.

[239] *Teachers Insurance and Annuity Association v. Tribune Co.*, ***supra*** note 117 at 499.

[240] *Winston v. Medicare Entertainment Corp.*, 777 F. 2d 78 (2d Cir. 1985).

[241] A.E Farnsworth, "Development in Contract Law During the 80s: the Top Ten", (1990) 41 Case W. Res. 203, at 210.

to sue Getty for breach of contract, but the action failed in the Delaware courts.[242] Pennzoil then sued Texaco for tortious interference with an alleged contract between Pennzoil and the Getty stockholders, in Texas. In 1988, the Texas Court of Appeals admitted that the parties were bound by the agreement in principle.[243] The Texas Court of Appeals has outlined the elements and facts necessary to consider that a preliminary agreement binds the parties: "Several factors have been articulated to help determine 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."[244]

In *Quake Construction, Inc.* v. *American Airlines, Inc.*, the judge Stamos, citing an unknown author, said that: "Because of their susceptibility to unexpected interpretations, it is easy to understand why letters of intent have been characterised by at least one practitioner as 'an invention of the devil.'"[245] The parties have to be careful in the drafting

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[242] *Pennzoil Co.* v. *Getty Oil Co.*, No. 7425 (Civ.) (Del. Ch. Feb. 6, 1984), online LEXIS.

[243] *Texaco Inc.* v. *Pennzoil Co.*, 729 S.W.2d 768 (Tex. Ct. App. 1987), cert. dismissed, 108 S. Ct. 1305 (1988). **[hereinafter *Penzoil*]**.

[244] ***Ibid.***

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

of the preliminary agreement in order that it perfectly reflects their will. Most of time, the commitments are beyond the original wish.[246]

The commencement of the performance is a key element for the judge to determine the intentions of the parties. The parties' subsequent behaviors can serve as evidence of the real nature of the letter of intent. For instance, a press release by the parties on their aspiration to be contractually bound may be an evidence of their intent to be bound.[247]

In *Anderson v. Source Equities, Inc.*,[248] the court considered that the parties intended to enter into a contract because they performed most of their obligations described in the preliminary document. In this case, the plaintiff's counsel had notified the defendant that the approval by his counsel was necessary to make the document valid. Although, the approval had not been given, the court did not take it into account.

In a case of 1971, the *Cour de cassation* said that the lower courts have to look for the intention of the parties in their subsequent behaviours, and not only in the convention.[249]

The drafting of the letter of intent may create ambiguity. Ambiguity is often due to the fact that they are drafted by non-legal staff, *i.e.*, commercial staff or engineers and not

[246] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 10.

[247] E.A. Farnsworth, ***supra*** note 47 at 262.

[248] *Anderson v. Source Equities, Inc.* 43 A.D.2d 921, 353 N.Y.S.2d at 1-2 (1974).

[249] Civ.III, 5 Feb.1971, D.1971, at 281. " Il appartient aux juges du fond de rechercher l'intention des parties contractantes dans les termes employés pae elles comme dans tout comportement ultérieur de nature à la manifester."

by lawyers. They are drafted at a stage of the negotiations when legal issues are not considered[250] and are ambiguous because the drafters aim to draft a document that will commit them as little as possible, but that nevertheless will bind their partners.[251]

Letters of intent are then considered as lying in an "unclear grey zone," which is an inappropriate situation for business people and their counsels[252].

Indefiniteness is a factor of complexity in determining if the parties have intended to be bound, and even if the parties have intended to be bound, the incoherence of the agreement may prevent the judge from enforcing it because of difficulties raised by the administration of such agreement.[253]

To avoid the aleatory decision of the French and American judges, the parties should clearly define the terms and conditions that will bind them.

2. The issue of completeness of preliminary agreements

The parties are free to stipulate conditions in their agreement that will have to be considered as essential terms for the formation of a final contract. Those conditions could be an agreement on price, the methods of payment, ... or a formal sanction of the final

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[250] R.B.Lake and U. Draetta, *supra* note 1 at 10.

[251] J.Ghestin, *supra* note 63 at 316.

[252] R.B.Lake and U.Draetta, *supra* note 1 at 10.

[253] A.L.Corbin, revised edition by J.M.Perillo, *supra* note 216 at 131.

contract by a lawyer.[254] An agreement on essential terms is evidence to determine the intention of the parties to be bound.[255]

Nonetheless, there may be a disagreement between the parties on the determination of essential terms. A term may be essential for one party and not for the other.

a) Defining essential terms

The conception and content of "essential terms" are a pure question of parties' intention and are subject to interpretation.[256] The importance of the terms depends upon the circumstances of each transaction. The same term may be essential in one agreement and subsidiary in another.

Under French law, Article 1583 of the Civil Code is related to the contract of sale and provides that the sale "is perfect when there is agreement on the thing and the price."[257] Therefore, unless the parties have explicitly specified upon which elements an agreement is necessary to form the final contract, if the parties have reached an agreement on the thing and the price, the contract is considered to be formed even if some points have still

[254] See, J.Schmidt, *supra* note 16 at 250.

[255] R.B.Lake and U.Draetta, *supra* note 1 at 71.

[256] *Ibid.* at 61.

[257] Article 1583 of the French civil Code decides that: "[La vente] est parfaite entre les parties, et la propriété est acquise de droit à l'acheteur à l'égard du vendeur, dès qu'on est convenu de la chose et du prix, quoique la chose n'ait pas encore été livrée ni le prix payé".

to be discussed.[258] In a case in 1980, the court held that a contract was not a binding agreement because no agreement was reached on price and methods of payment.[259]

A letter of intent that contemplates a future contract may contain settled terms for which the parties have come to an agreement. Those settled terms are often essential terms of the future contract. The letter of intent is not called a contract because the parties contemplate a future formal agreement, drafted by lawyers and completed by legalisms. However, the intention of the parties to be bound may be questioned if a dispute arises before the finalization of a final contract.[260] As discussed above, the manifestation of an intention to enter a subsequent contract is not a conclusive evidence to demonstrate that the pre-contractual agreement is not enforceable.[261] The substantiality of the contemplated contract is an element to determine if the pre-agreement can be considered as the final contract, although the judge cannot presuppose the existence of a contract when the parties have specifically mentioned the elements essential for the definitive conclusion of their contract and if the said elements are not agreed upon.[262]

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[258] J. Schmidt-Szalewski. ***supra*** note 160 at 91.

[259] Cass.com. 9 June 1980. Gaz.Pal.. 1980. 2. Somm.

[260] E.A.Farnsworth and W.F. Young. ***supra*** note 136 at 150.

[261] However. in *Upsal Street Realty Co. v. Rubin*. despite an agreement was reached on major terms. the American judge refused to enforce the proposed contract because no agreement was found on details. *Upsal Street Realty Co. v. Rubin*. 326 Pa: 327. 192 A: 481 (1937).

[262] P. Jourdain. ***supra*** note 8 at 131.

Professor Knapp has established methods of interpretation in order to determine to what extent the drafting of a formal contract would not be a mere reformatting of the letter of intent, but would add substantial provisions.[263]

Professor Knapp has listed several factors aiming to demonstrate that a subsequent contract is a mere formality and that a preliminary agreement, containing all the essential terms, is a binding agreement. These factors are: (1) no independent policy of the law requires a writing for enforceability or, if one does, that the parties satisfied the requirement by means of exchanges or telexes and such, (2) the agreement is relatively simple, not involving long-term obligations, (3) the subsequent written contract is a standard form agreement, and (4) the parties have begun performance.[264] Those facts can be illustrated by oral evidence or other preliminary documents.

On the other side, Professor Knapp has also listed various factors aiming to demonstrate that a preliminary agreement was dependent on the conclusion of a subsequent contract. These factors are: (1) the agreement is of a type that requires a writing for enforceability under the statutes of frauds; (2) the agreement involves large sums of money; (3) the agreement has many details; (4) the agreement is an unusual one, for which a standard form agreement is not available or appropriate; and (5) the parties were unwilling to proceed prior to the execution of the subsequent written contract.[265]

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[263] R.B.Lake and U.Draetta, ***supra*** note 1 at 16-17.

[264] C.L. Knapp, ***supra*** note 15 at 683.

[265] ***Ibid.***, at 682.

The particular French theory of "*punctation*," inspired by the German theory of *punctatio*, justifies that a letter of intent may be found to be a final contract. The *punctation* theory is not ruled by the Civil Code.

The theory of *punctation* is the theory of a contract settled point by point. As discussed above, several consents can be given on various points during the negotiation process. Before the final conclusion of the agreement, successive written documents record the various points on which the parties have reached an agreement. The legal force of these documents varies: some documents are only secretarial documents and other contain agreement on essential terms of the final contract. Therefore, a contract may be concluded point by point and the judge may conclude that a final contract has been reached. The French judge has competence to fulfil minor unsettled points. A disagreement on secondary points does not prevent the conclusion of a contract.[266] In a case in 1962, the contracting parties agreed on the price and the purpose of a sale but nothing was planned for the methods of payment. The judge held that a lack of agreement on methods of payment could not prevent the performance of the sale.[267]

The agreement on essential and material terms characterizes the existence of a binding contract in French and American law. This reasoning suggests that, today, and particularly in American law and in common law in general, the question at stake is whether the

[266] P.Malaurie and L.Aynès, *supra* note 150 at 216.

[267] Civ.I. 26 Nov. 1962, Bull.I. no.504.

parties have entered a contract, and not whether the parties have intended to make a contract.[268]

b) Supplying missing terms

In situations where French and American courts consider that parties have intended to create a contract, it may be necessary for the judges to fill gaps, *i.e.*, to construe missing terms.

Missing terms may indicate that the parties are still in negotiations and have not yet reached a final agreement. However, it does not necessarily prove that a contract does not exist. According to Section 2-204(3) of the U.C.C., the contract exists in spite of missing terms, if there is a reasonably certain basis for an appropriate remedy.[269] American courts have the power to imply reasonable terms. They can supply terms relating to the price if it has been left opened by the parties. § 2-305 of the U.C.C.[270] gives directions to determine

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[268] P.Atiyah, *An introduction to the law of contract*, 3rd ed. (Oxford: Clarendon Press, 1981), at 7.

[269] Under American law, the issue of manifestation of intention is closely linked with the issue of certainty of terms. The concept of certainty of terms is based, in part, on the possibility for the judge to determine an appropriate remedy from the contract provisions.
The Section 2-204(3) of the U.C.C. provides that: "Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy."
The Section 33(2) of the Restatement Second also provides that: "The terms of a contract are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy."

[270] (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if
(a) nothing is said as to price; or
(b) the price is left to be agreed by the parties and they fail to agree; or
(c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by the third or agency and it is not so set or recorded.
(2) A price to be fixed by the seller or by the buyer means a price for him to be fix in good faith.

the price in a sale contract. Under French law, if the parties have agreed upon the essential terms and have recorded this agreement in a pre-contractual document, the French courts can use Article 1135 of the Civil Code,[271] in order to complete the pre-agreement and to settle the contract. In accordance with this article, the parties have to perform their obligations not only in respect to the content of the contract, but also in respect to equity, usage and law.

The issue of missing terms often arises in cases involving letters of intent with open terms. There is always a risk that no agreement be reached on open terms. Under American law, if no final agreement is reached in spite of continuing negotiations, the judge may supply the missing terms.[272] In several cases, courts have supplied missing terms because of the failure of the negotiations.[273] For instance, in the case *American Cyanamid Co. v. Elisabeth Arden Sales Corp.*, the court considered that the agreement contained the essential terms and supplied the missing terms. Two of those terms were the closing date and the date for the signing of a formal agreement.[274]

In French law, in case of failure of negotiations on open terms, the partial contract is still enforceable. Thus, because of their initial agreement on the essential terms, the parties

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(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as canceled or himself fix a reasonable price.

[271] Article 1135 of the French civil Code: "Les conventions obligent non seulement à ce qui y est exprimé, mais encore à toutes les suites que l'équité, l'usage ou la loi donnent à l'obligation d'après sa nature."

[272] E.A. Farnsworth, ***supra*** note 47 at 250.

[273] **See also.** *Purvis v. United States*, 344 F.2d 867 (9th Cir. 1965).
E.A. Farnsworth, ***supra*** note 47 at 255.

[274] *American Cyanamid Co. v. Elisabeth Arden Sales Corp.*, 331 F. Supp. 597 (S.D.N.Y. 1971).

are definitely and irrevocably bound. In a way, they are "condemned" to get on well.[275] The issue of indefiniteness is then superseded by the issue of the intent to be bound.[276] The partial agreement can be completed by a third party: a judge or an arbitrator appointed by the parties.[277] The judge could refer to law, usage or the parties' will. The interpretation is sometimes necessary to discover the parties' will, regarding the importance of the terms not discussed.

Substantial performance or the taking of material action based on the terms of the preliminary agreement is an important factor in analyzing the completeness of the agreement.[278] In *Morris v. Ballard*, the court said: "when a contract has been partly performed by the plaintiff, and the defendant has received and enjoys the benefits thereof, and the plaintiff would be virtually remediless unless the contract were enforced, the court, from the plainest considerations of equity and common justice, does not regard with favor any objections raised by the defendant merely on the ground of the incompleteness or uncertainty of the agreement."[279]

The essential terms have to be interpreted in accordance with each transaction. The position of the French and American courts varies with the content of the pre-contract.

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[275] J.Flour, J-L Aubert, ***supra*** note 120 at 103.

[276] E.A. Farnsworth, ***supra*** note 47 at 256.

[277] The preliminary agreement can contain a provision appointing an arbitrator and stating that: "in case of difficulties to reach a final agreement on the open terms, we shall refer to the arbitration of ..." J.Schmidt, ***supra*** note 16 at 251-252.

[278] A.L.Corbin, revised edition by J.M.Perillo, ***supra*** note 216 at 141.

[279] *Morris v. Ballard*, 16 F;2d 175, 56 App.D.C. 383, 49 A.L.R. 1461 (1926).

However, by filing the gaps of the contract, there is a risk that the judge drafts the contract for the parties. Besides, the gaps are the basis of the judge's freedom to include his own justice and social standards.

Parties should determine and set the different phases of the negotiations that will have a binding effect. These procedures will avoid further misunderstandings, as to the binding force of commitments, and will allow to identify the key elements on which a consent is necessary to create a future contract.

Chapter IV. Liability and damages

Parties entering negotiations have to keep in mind the possibility of a failure. In Farnsworth' words: "a party that enters negotiations in the hope of a gain that will result from ultimate agreement bears the risk of whatever loss results if the other party breaks off the negotiations."[280] However, although there is no obligation for the parties to reach a final contract, the breaking off of negotiations without appropriate reason and in an abuse manner, may cause prejudice to one party that may have legitimate belief that the contract would be soon concluded.

In France and in the United States, an unfair breakdown of negotiations may lead to liability in case of prejudice caused to a party. In France, if a party suffers damage due to the opposite party's fault, compensation will be granted in tort. American courts use restitution, misrepresentation and promissory estoppel to sentence inappropriate breaking off negotiations.

Binding preliminary agreements or binding obligations, are considered to be of contractual nature and thus are ruled by contract law. A failure to fulfil the pre-contractual obligations will lead to liability. The parties can foresee liability and damages in their preliminary agreement. Therefore, the pre-contractual provisions and contract law in general will rule the parties' relations.[281]

[280] E.A. Farnsworth, *supra* note 47 at 221.

[281] J. Schmidt-Szalewski, *supra* note 160 at 93.

A. The pre-contractual fault

With respect to the concept of freedom of contract, unjustified interruption of negotiations or parallel negotiations with third parties are not generally prohibited. However, it could become contrary to the duty of good faith when the parties have reached an advanced stage in the negotiation process. This advanced involvement is emphasised when a letter of intent, recording the points on which the parties already come to an agreement, exists.[282]

Under French and American law, it is commonly recognized that, based on the respect of a good faith behavior, the more the negotiations are going on, the less the parties can refuse to finalize the contract. An acceptable behavior at the signature of a letter of intent may be considered unfair at the end of the negotiations.[283]

In France, the Court of Appeal of Riom said that: "freedom is the principle in contractual relations, including freedom to interrupt the negotiations at any time. However, if, because of the length and the seriousness of the negotiations, a party has legitimately believed that the other party would conclude a final contract, the breaking off constitutes a fault."[284]

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[282] R.B.Lake and U.Draetta, ***supra*** note 1 at 184-185.

[283] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 30-31.

[284] CA Riom, *RTD civ.* 1993, at 343.

To determine pre-contractual liability at the negotiations phase, the French and American courts examine the circumstances of the breaking off and consider the duration of the negotiations period.[285]

The parties' behavior is the utmost evidence for the American and French judges to establish bad faith. Such behaviors could be: refusing to disclose information relevant to the negotiations, rejecting routine provisions, shifting bargaining positions when agreement is near, engaging in dilatory tactics, or withholding agreement on trivial matters.[286] The blameworthy party could be the one who has broken the negotiations with gross negligence, who has engaged in wilful misconduct,[287] or who has entered into negotiations with no intention to conclude a final contract, or with the only aim to take advantage of the information given by the opposite side.[288] A clause of confidentiality aims to protect information exchanged during the negotiations, such as know-how, commercial and financial information, commercial strategies, list of clients,... Those information aim to clear the parties' will to conclude or not a final contract. The use of those information for a purpose different than the conclusion of contract is against good faith and constitutes a fraud.

In France and in the United States, parties who have such bad faith behaviors are likely held liable. For instance, in 1929, the Court of Appeal of Rennes sanctioned a party

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[285] See. J-M. Loncle and J-Y Trochon. ***supra*** note 11 at 33.

[286] E.A. Farnsworth. ***supra*** note 47 at 272.

[287] The exact French concept is "*faute lourde*" or "*faute intentionelle*".

[288] R.B.Lake and U. Draetta. ***supra*** note 89 at 849.

that had left the negotiations without legitimate reasons.[289] In *Gray* v. *Eskimo Pie Corp.*,[290] negotiating without an intent to conclude a deal in order to obtain commercial advantage over another has also been held fraudulent.

In France and in the United States, rather than an obligation to negotiate in good faith, it is finally better to consider an obligation not to negotiate in bad faith.[291]

Under French law, two elements are required to consider that the breakdown of the negotiations constitutes a fault: first, the breakdown must be abrupt, unexpected and second, the breakdown must be close to the conclusion of a final contract.[292] In a case in 1969,[293] the Court of Appeal of Pau stated that "certain obligations of honesty and fair dealing (*rectitude et loyauté*) rest on the parties in the conduct of negotiations, but fault in *culpa in contrahendo* must be obvious and beyond dispute. Otherwise there would be grave interference with freedom of contract and the security of commercial transactions."

It has been highlighted that most American courts are reluctant to find a general obligation of fair dealing or a duty to negotiate in good faith during the stage of contractual negotiation. For many American judges, bad faith and dishonesty are not necessarily immoral in the negotiations process, if the purpose is not to mislead or

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[289] CA Rennes, 8 July 1929, Recueil Périodique Hebdomadaire de Jurisprudence, at 548.

[290] *Gray* v. *Eskimo Pie Corp.*, 244 F.Supp. 785, 789-94 (D. Del. 1965).

[291] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 30-31.

[292] 94ème Congrès des Notaires de France, ***supra*** note 24 at 24.
See generally, B. Nicholas, *The French Law of Contract, 2nd ed.* (New York: Clarendon Press Oxford, 1992).

[293] CA Pau, 14 January 1969, D. 1969, p.716.

deceive.[294] In *Belcher* v. *Import Cars*,[295] the Court admitted that the parties were free to break off negotiations, in good or bad faith, because no formal agreement was reached. On the other hand, some courts have imposed liability on the withdrawing parties.[296]

The most significant case of the American courts' opinion is *Feldman v. Allengheny International.*[297] In that case, the court held that self-interest cannot be termed bad faith. According to Justice Coffey, "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 and the free market." When a party has to face the bad faith behavior of the opposite side, the proper course is "to walk away from the bargaining table, not to sue for 'bad faith' in negotiations."[298]

American courts tend to privilege freedom to contract. As long as an enforceable agreement has not been reached, each party is free to leave and there is no contractual liability.[299] In accordance with the American "aleatory view" of negotiations, each party has to be aware that there is a risk that no agreement be reached, despite time, money and efforts invested in the negotiation process.[300] Moreover, the common law view also aims

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[294] See. R. S. Summers. ***supra*** note 50 at 204-205.

[295] *Belcher* v. *Import Cars, Ltd.*, 246 So.2d 584 (Fla. 1971).

[296] H.L. Temkin. "When Does the 'Fat Lady' Sing ?: an Analysis of 'Agreements in Principle' in Corporate Acquisitions". 55 (1986) Ford L. Rev. 125. at 130.
See ***e.g.***, *Penzoil*, ***supra*** note 243.

[297] *Feldman v. Allengheny International*, ***supra*** note 140.

[298] ***Ibid.*** at 1223.

[299] E.A. Farnsworth and W.F. Young, ***supra*** note 136 at 264.

[300] F.W.Claybrook. Jr., "Good Faith In The Termination And Formation Of Federal Contracts." (1997) 56 Md. L. Rev. 555. at 582.

to avoid the "finding of the existence of a contract based on perceived reprehensible conduct rather than on the traditional benchmark of mutual expectation."[301]

In France, good faith gives to the judge a large discretion over private transactions, and above all, the power to determine what characterizes an unfair behavior in business practices.[302] Liability is used by courts to the extent necessary to avoid an injustice.

B. The legal basis of liability in letter-of-intent situations

1. The application of the law of torts in France

In most civil law countries, the doctrine of *culpa in contrahendo* is the foundation of a general theory of pre-contractual liability.[303] *Culpa in contrahendo* means "fault in negotiation."

This doctrine comes from Germany. Ihering, a German legal scholar, developed this doctrine for the first time in 1861.[304] It has been analyzed as a reaction to the "formalistic nature of West German contract law prior to the adoption of the Bürgerliches Gesetzbuch

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[301] J. Klein and C. Bachechi, ***supra*** note 7 at 4-5.

[302] G.R. Shell, "Contracts in the Modern Supreme Court", (1993) 81 Calif. L.Rev. 431, at 494-495.

[303] R.B.Lake and U.Draetta, ***supra*** note 89 at 851.

[304] R. Von Jhering, "A Culpa in contrahendo oder Schadensersatz bei nichtigen oder nicht zur Perfection gelangten Verträgen", in *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts*, [Yearbooks of the dogmatic of the modern roman and German private law] (1861) Vol.4, at 10112.

in 1891."[305] According to Ihering's doctrine "a slip of the pen, an erroneous transmission of an offer or acceptance, an essential unilateral mistake as to the identify of the other party or of the subject matter, however impalpable, fatally affected the validity of the contract."[306] The party who has caused the invalidity or the imperfection of the contract is liable for the prejudice of the opposite party who has relied, in good faith, on the conclusion of the contract. The doctrine of *culpa in contrahendo* states that damages should be recoverable against the blameworthy party who has caused the failure of the conclusion of the contract.[307] It is legitimate for this party to receive restitution and reliance damages. The blameworthy party is not entitled to any recovery.[308] The doctrine of culpa in contrahendo is the logical corollary of the duty to negotiate in good faith. The theory of Ihering assumes the implicit existence of a preliminary contract by which the parties undertake to negotiate in accordance with the *diligentia in contrahendo*.

The theory of *culpa in contrahendo* has been rejected by the French doctrine.[309]

Under French law, if no binding pre-contract exists between the parties, the pre-contractual liability is in torts.[310] This principle has been stated by the *Cour de cassation* in 1984.[311]

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[305] R.B.Lake and U.Draetta, ***supra*** note 89 at 851-852.

[306] R. Von Jhering, ***supra*** note 304.

[307] ***Ibid.***

[308] F. Kessler and E. Fine, ***supra*** note 111 at 401-409.

[309] **See generally**, R.Saleilles, "De la responsabilité précontractuelle", (1907) Rev. trim. dr. civ. 697.

[310] *faute délictuelle.*

[311] Cass.com. 11 Jan. 1984, Bull.civ., IV, no.16, at 13.

Torts law is applied if a party has suffered damages because of the blameworthy conduct of the opposite party. Such liability results from Articles 1382 and 1383 of the Civil Code. Article 1382 provides: "Any act whatever of man which causes damage to another obliges him by whose fault it occurred to make reparation".[312] Article 1383 provides "Each one is liable for the damage which he causes not only by his own act but also by his negligence or imprudence".[313]

In a pre-contractual situation, the fault is characterized by a wrongful behavior that a reasonable man, under the same circumstances, would not have committed. This fault must be obvious and indisputable. The bad behavior need not be intentional.[314] Pre-contractual liability does not require the party's intention to cause a prejudice. Pre-contractual liability only requires a fault and a bad faith behavior.[315]

2. The use of misrepresentation, restitution and promissory estoppel in the United States.

The doctrine of *culpa in contrahendo* has not gained acceptance in common law jurisdictions.[316] However, this does not mean that the party who has suffered prejudice

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[312] Article 1382 of the Civil Code: "Tout fait quelconque de l'homme, qui cause à autrui un dommage, oblige celui par la faute duquel il est arrivé, à le réparer."

[313] Article 1383 of the Civil Code: "Chacun est responsable du dommage qu'il a causé non seulement par son fait, mais encore par sa négligence ou par son imprudence."
R.B.Lake and U.Draetta, ***supra*** note 89 at 849.

[314] CA Pau, 14 January 1969, ***supra*** note 293.

[315] J.Ghestin, ***supra*** note 63 at 296.

[316] E.H.Hondius, ed., *Precontractual liability. Reports to the XIIIth congress*, International Academy of Comparative Law, Montreal, Canada, 18-24 August 1990, (Deventer: Kluwer Law and Taxation Publishers, 1991), at 5.

remains without remedy.[317] In the case *Venture Assocs. Corp. v. Zenith Data Systems Corp.*, the court said that: "injecting new demands, such as an increase in price, late in the negotiating process can constitute bad faith in some circumstances."[318] However, American courts tend to use misrepresentation, restitution or promissory estoppel rather than the breach of the good faith duty to sanction unfair conducts and allow damages. The *Venture* case is an exception.[319]

Misrepresentation is characterized by "a false or misleading statement about a material fact, which may be grounds for rescinding a contract or for the recovery of damages in contract or tort."[320]

In the case *Goodman* v. *Dicker*,[321] liability and the awarding of damages were based on misrepresentation. This case involved a disappointed applicant for a franchise who sued the local distributors on the ground that they had induced him to incur expenses with a view to doing business under the franchise. The local distributor argued that even if the franchise had been granted, "it would have been terminable at will and would have imposed no duty upon the manufacturer to sell or [the applicant] to buy any fixed number of radios." The court granted the disappointed party $ 1,150 to compensate the expenses incurred to do business. The court held: "Justice and fair dealing require that one who acts

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[317] J. Klein and C. Bachechi. ***supra*** note 7 at 7.

[318] *Venture Assocs. Corp. v. Zenith Data Systems Corp.*, 987 F.2d 429 (7th Cir. 1993).

[319] See. N.E.Nedzel. "A Comparative Study of Good Faith. Fair Dealing and Precontractual Liability". (1997) 12 Tul.Eur.& Civ.L.F. 97. at 122.

[320] Gilbert Law dictionary. (Orlando. Fl.: Harcourt Brace and company. 1994). at 164.

[321] *Goodman* v. *Dicker*. 169 F.2d 684 (D.C.Cir.1948).

to his detriment on the faith of the conduct of the kind revealed here should be protected by estopping the party who has brought about the situation from allowing anything in opposition to the natural consequences of this own course of conduct."[322]

The law of restitution, or unjust enrichment, can also provide the basis for remedy in case expenses have been incurred in the expectation of the conclusion of a contract. The plaintiff must demonstrate that his acts have resulted in an actual benefit to the defendant.[323] The necessary elements to support a claim for unjust enrichment include: "(1) valuable services rendered, or materials furnished; (2) to the party to be charged; (3) the services or materials were accepted, used and enjoyed by the party, and (4) under circumstances which reasonably notified the party to be charged." The evaluation of the damage for the plaintiff is *quantum meruit*, as much as he deserves.[324]

The use of the theory of promissory estoppel is controverted.

Promissory estoppel is defined in § 90 of the Restatement Second which provides that:

> "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."[325]

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[322] E.A. Farnsworth and W.F. Young, ***supra*** note 136 at 264.

[323] E.H. Hondius, ***supra*** note 316 at 13.

[324] *Puncratz Company, Inc., v. Kloefkorn-Ballard Const. Develop., Inc.*, 720 P. 2d (Wyo. 1986). D.C. Turack, *American report*, in E.H.Hondius, ed., *Precontractual liability. Reports to the XIIIth congress.* International Academy of Comparative Law, Montreal, Canada, 18-24 August 1990. (Deventer: Kluwer Law and Taxation Publishers, 1991), at 347-348.

[325] Restatement (second) of contracts § 90, (1981).

Under promissory estoppel, the promisor can be held liable if the promise has been made to the promisee's detriment.

In *Hoffman* v. *Red Owl Stores*,[326] the parties had undertaken lengthy negotiations with the aim to establish a franchise of a supermarket. On the request of Red Owl, Hoffman spent large amounts of money. According to Red Owl, the conclusion of the final contract was a formality. Later, Red Owl refused to execute the contract. Despite the absence of a formal contract, the court granted Hoffman reliance damages.[327]

In the *Red Owl* case, the claim for reliance damages of the disappointed party was based on promissory estoppel. On appeal, Red Owl argued the enforceability of the contract. He argued that "such promise must have the same degree of definiteness and certainty as is required for ordinary bilateral contracts" to serve as the basis of promissory estoppel.[328] This argument was rejected. This argument has also been rejected in other cases.[329] Nonetheless, the *Red Owl* case did not give precise indications to estimate how much reliance was necessary to admit pre-contractual liability based on promissory estoppel.[330]

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[326] *Hoffman* v. *Red Owl Stores*, 133 N.W.2d 267, 267 (Wis. 1965). **[hereinafter, *Red Owl*].**

[327] **See *ibid.* at 268-277**

[328] Appellants' Brief at 36, *Red Owl* ***supra*** note 326.

[329] **See *e.g.*, *Wheeler* v. *White*, 398 S.W.2d 93 (Tex. 1965) and *Morone* v. *Morone*, 50 N.Y.2d 481, 413 N.E.2d 1154, 429 N.Y.S.2d 592 (1980).**

[330] D.C. Turack, ***supra*** note 324 at 346.

This case has emphasized the importance of good faith in negotiations and the protection of the reliance interest even in the face of limited commitment.[331]

However and although the *Red Owl* case has been cited in other similar cases,[332] the use of promissory estoppel to resolve issues raised by letters of intent has often been rejected by courts.[333] Courts are reluctant to use promissory estoppel in preliminary agreement situations. This reluctance has been justified by the obligation to respect the Statute of frauds,[334] the non-existence of a promise to rely on,[335] or the unreasonableness of the reliance.[336]

As Professor Farnsworth has noticed: "the impact of Red Owl has not lived up to its promise". He suggests that a possible greater burden on the claimant to prove the promise, the justification of reliance on the promise during negotiations, or the absence of precise criteria to determine reliance damages could be reasons for the lack of a greater impact of the *Red Owl* case.[337]

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[331] J.M. Feinman, "Promissory Estoppel and Judicial Method", (1984) 97 Harv. L. Rev. 678, at 694.

[332] See *e.g.*, *Werner* v. *Xeros Corp.*, 732 F.2d 580 (7th Cir. 1984) and *Vigoda* v. *Denver Urban Renewal Authority*, 646 P.2d 900 (Colo. 1982)

[333] See *e.g.*, *Reprosystem*, ***supra*** note 127.
R.B.Lake and U.Draetta, ***supra*** note 89 at 847.

[334] See *e.g.*, *Chromalloy Am. Corp. v. Universal Housing Sys. Of Am., Inc.*, 495 F.Supp. 544 (S.D.N.Y.) 1980), *aff'd mem.*, 697 F.2d 289 (2d. Cir. 1982).

[335] See *e.g.*, *Reprosystem*, ***supra*** note 127.
See also, *Pacific Cascade Corp.* v. *Nimmer*, 25 Wash. App. 552-558, 608 P.2d 266-270 (1980). At Pacific Cascade's request, Nimmer had executed a letter of intent. In reliance on this letter, Nimmer undertook many actions. But the court concluded the letter of intent was not a promise that could be relied upon.

[336] See *e.g.*, *Continental Fin. Servs. v. First Nat'l Boston Corp.*, No. 82-1505-T, slip op. at 16 (D. Mass. Aug. 30, 1984).

[337] E.A. Farnsworth, ***supra*** note 47 at 238-239.

The use of promissory estoppel in the pre-contractual period raises controverted reactions because it completely disregards the basic rules of contract formation: the existence of an offer and the acceptance of this offer. The *Red Owl* case did not even involve an offer. Therefore, courts have often concluded that the defendants, and not the plaintiffs, needed protection because they relied on the formal rules of offer and acceptance, and because the plaintiffs should have foreseen that a risk existed until the conclusion of a formal contract.[338] The courts are also aware to avoid that parties be bound by informal agreements made at the stage of the negotiations.[339]

Even though promissory estoppel has been applied in cases involving a negotiation situation with no final agreement,[340] the general principle is that "an agreement that is too indefinite to be enforced as a contract cannot serve as a basis for promissory estoppel."[341] The promise relied upon has to be definite, reasonable and foreseeable. The reasonableness of the promise is a factual issue, determined by a jury.[342]

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[338] See. A. Katz. "When Should an Offer Stick ? The Economics of Promissory Estoppel in Preliminary Negotiations." (1996) 105 Yale L.J. 1249. at 1254-1255.

[339] ***Ibid.*** at 1263-1264.

[340] See ***e.g.***, *Drennan v. Star Paving Co.*, 51 Cal. 2d 109. 333 P.2d 757 (1958); *Reynolds v. Texarkana Constr. Co.*, 237 Ark. 583. 374 S.W.2d 818 (1964).

[341] See *Original Appalachian Artworks, Inc.* v. *Schlaifer Vance & Co.*, 679 F. Supp. 1564. 1581 (N.D. Ga. 1987). See also. *American Viking Contractors* v. *Scribner Equip. Co.*, 745 F.2d 1365. 1372 (11th Cir. 1984) (finding that reliance upon indefinite promises is not reasonable and does not give rise to estoppel).

[342] *Rosnick v. Dinsmore*, 235 Neb. 738. 743-749. 457 N.W.2d 793 (Neb.1990).

The French concept of natural justice may be considered as the equivalent of the American promissory estoppel doctrine. This assertion is illustrated by the application of promissory estoppel by the courts of Puerto Rico, where a Civil Code is in force.[343]

In *Ramirez v. Gautier*, the court explained that the American "promissory estoppel case law acknowledges pre-contractual liability on grounds similar to those applied by civil law in notions of good faith and culpa in contrahendo."[344] In other words, promissory estoppel is an equitable theory that protects reliance in the negotiation and formation of contracts. Although the Civil Code of Puerto Rico does not explicitly admit the doctrine of promissory estoppel, this doctrine has been incorporated by judicial decisions in the law of Puerto Rico.

The use of estoppel, misrepresentation, unjust enrichment, and the duty of good faith as means of punishment of blameworthy behavior, can be considered as the common law expression of the doctrine of culpa in contrahendo. This doctrine has been analyzed as the "underlying philosophy" of the above concepts used by the American courts.[345]

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[343] See E. Mills Holmes, "Restatement of Promissory Estoppel", (1996) 32 Willamette L. Rev. 263, at 450-451. The courts of Puerto Rico justified the creation of promissory estoppel by citing Article 7 of the Puerto Rico Civil Code, 31 L.P.R.A. 7 (1968), adopted from Article 6 of the Spanish Civil Code, which provides: "When there is no statute applicable to the case at issue, the court shall decide in accordance with equity, which means that natural justice, as embodied in the general principles of jurisprudence and in accepted and established usages and customs, shall be taken into consideration."
The case *Whirlpool Corp. v. U.M.C.O. Int'l Corp.*, contains an extensive explanation of the doctrine of culpa in contrahendo and distinguishes it from promissory estoppel.
Whirlpool Corp. v. U.M.C.O. Int'l Corp., 748 F. Supp. 1557, 1562-64 (S.D. Fla. 1990)

[344] *Ramirez* v. *Gautier*, 87 P.R.R. 470, 481, 493-95 & n.16 (1963).
In Puerto Rico, the civil law doctrine, grounded on the values of culpa in contrahendo and good faith, is embodied in Article 1802, 31 L.P.R.A. 5141 which states: "A person who by an act or omission causes damage to another through fault or negligence shall be obliged to repair the damage so done. Concurrent imprudence of the party so aggrieved does not exempt from liability, but entails a reduction of the indemnity."

[345] F. Kessler and E. Fine, ***supra*** note 111 at 448.

The notion of good faith remains an imprecise concept that can only be expressed through legal concepts that are more precisely defined. Promissory estoppel, unjust enrichment, and misrepresentation are those concepts that give to good faith a legal meaning.[346] In general, immorality and lack of ethics have been the origins of many legal causes of action.[347]

3. The non respect of pre-contractual provisions.

Parties can foresee any type of damages for any type of breaches of obligations in their preliminary agreement. Such clauses avoid difficulties raised by the issue of pre-contractual liability.[348] The parties have the possibility to stipulate a liquidated damages clause in case of breaches of certain obligations.

Parties may organize their relations, define their commitments and determine what kind of behaviors shall be deemed to be unfair and shall lead to liability. The clauses have to be precisely drafted. It is essential to clearly determine the commitments and the consequences of breaches of obligations. For instance, concerning a clause of confidentiality, the parties will have to define exactly what will be confidential, who will have access to the confidential information and under which conditions, which kind of breaches will lead to damages and the amount of those damages.[349]

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[346] See. P. Jourdain. ***supra*** note 8 at 132.

[347] L.A. DiMatteo. ***supra*** note 40 at 102-103.

[348] M.Fontaine. *Formation of contracts and Precontractual liability. Concluding report.* (Paris: ICC Publishing S.A., 1990) at 351.

[349] ***Ibid.*** at 352.

To avoid a risk of liability, the parties can expressly mention in their letter of intent that, in case of failure to reach a final agreement or to pursue negotiations for whatsoever reason, the failed party will not be exposed to any liability.

Parties can also include in their preliminary agreements provisions excluding or limiting liability consequently to the breaking off negotiations. Under French and American law, such disclaimers are not effective in case of fraudulent breaks in negotiations.[350] In French law, parties cannot totally exclude good faith. As discussed above, good faith is a universal principle overriding contract law.

In the presence of a contract to negotiate, the breaking off of negotiations or the refusal to negotiate without serious intent may constitute a fault resulting in damages. However, if no final agreement is reached and if no party has failed to fulfil her duty to negotiate, the parties will not be bound by any agreement.[351] The failure may be caused by the expression of unacceptable proposals, either ridiculous or disproportionate.[352]

In the context of an enforceable agreement with open terms, a party may be held liable if, by failing to fulfil her obligation to negotiate, she causes the failure of the final agreement.[353]

In France, the contract to negotiate creates an obligation to negotiate in good faith. The breaking off negotiations without serious prior discussion and formulation of

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[350] R.B. Lake and U. Draetta, ***supra*** note 1 at 177.

[351] E.A. Farnsworth, ***supra*** note 47 at 251.

[352] J.Schmidt, ***supra*** note 16 at 207.

[353] E.A. Farnsworth, ***supra*** note 47 at 250.

counterproposals justifies the termination of the contract to negotiate and the awarding of damages.[354] Besides, in the presence of a letter of intent, parallel negotiations, even in the absence of an express prohibition to conduct parallel negotiations, may be considered as being contrary to the general good faith obligation.

The vagueness of the notion of fair dealing, good faith and best efforts may be a reason for the court to refuse the enforcement of an agreement to negotiate in good faith and to deny the awarding of reliance damages.[355] However, as discussed above, today, the concepts of good faith and best efforts become more precise thanks to case law and doctrine. Besides, the parties have the possibility to define those concepts in their preliminary agreement.

The presence of a preliminary agreement, enforceable or not, facilitates the proof of breaches of pre-contractual obligations.

For instance, in case of an unenforceable preliminary agreement to negotiate in good faith, it is easier to sanction an unfair behavior because the preliminary agreement shows, at least, that there is an explicit duty to negotiate in good faith.[356]

[354] Cass.civ.I. 8 October 1963. Bull.civ.I. no.419. at 359.
J.Ghestin. ***supra*** note 63 at 318.

[355] E.A. Farnsworth. ***supra*** note 47 at 267.

[356] See. M.Fontaine. ***supra*** note 348 at 350.

A case of September 21, 1995 of the Court of Appeal of Paris[357] perfectly illustrates how letters of intent, even if not enforceable, strengthen the general obligation to behave in good faith at the negotiation stage.

In this case, the company Sandoz and the company Poleval had a project in common. For four years, they exchanged letters of intent in order to implement the project. The company Sandoz suddenly broke off the negotiations for reasons not linked to the project. The company Poleval's claim for damages was based on the non-performance of an implicit contract concluded by both parties, and on tort for misuse of negotiations. The Court of Appeal admitted the existence of a contract, particularly because of the exchange of contract projects. It also admitted that Poleval had suffered damages based on the fact that Sandoz had let Poleval hope for four years. The court found bad faith, given the expectations that Sandoz had generated. The prejudice was assessed at four million French francs.[358] The fault of Sandoz was characterized by the breaking off of long term negotiations without serious reasons.[359]

Particular circumstances surrounding each negotiation make difficult the determination of the moment the parties enter a formal contract. Such imprecision allows courts to protect and compensate, sometimes in discretion, the party who has relied.[360]

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[357] CA Versailles. 21 September 1995. RJDA 2/96 no. 178.

[358] *i.e.*, more than 650.000 US dollars.

[359] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 30-31.

[360] E.A. Farnsworth and W.F. Young, ***supra*** note 136 at 248.

C. Damages

As one English judge has expressed it, a negotiating party "undertakes this work as a gamble, and its cost is part of the overhead expense of his business which he hopes will be met out of the profits of such contracts as are made."[361] As neither party to contractual negotiations is bound until an offer has been accepted, there is a risk for the parties in relying and acting in perspective of the future contract.

However, in French and American law, a party who has suffered a prejudice because of the fault behavior of the opposite side, is entitled to compensation. The plaintiff has to demonstrate the existence of a prejudice and its importance. The courts have to evaluate the damages.

The awarding of damages by courts, in case of bad faith behavior causing prejudice during the pre-contractual process, demonstrates the judges' concern to introduce moral standards into the marketplace.[362]

1. The awarding of reliance damages

Expectation damages are admitted under French and American law. Expectation damages are the "damages compensating the injured party for the loss of the benefits

[361] *William Lacey (Hounslow) Ltd. v. Davis*, [1957] 1 W.L.R. 932, 934 (Q.B. 1957).

[362] See, N.W. Palmieri, *supra* note 33 at 108-109.

which that party would have received had the contract been performed."[363] However, when a contract to negotiate is at stake, French and American courts are more likely to award reliance damages than expectation damages.[364] The party who has reasonably relied upon the promise of the other party is entitled to be compensated. This is defined as the reliance interest.[365] This reliance depends on the nature of the letter of intent. Reliance damages can be defined as follows:

> They are measured by the amount of money necessary to compensate the innocent party for expenses or loss incurred in reasonable reliance upon the contract that was breached. [...] Reliance damages are designed to place [the victim] in the position he was in before the contract was made. Reliance damages are designed to restore the status quo. The victim is not given any profit or benefit of the contract but is merely being made whole.[366]

The reliance is likely reasonable and foreseeable when the parties have spent a long time in negotiations.[367]

The French judge considers that the damage cannot be based on expectation damages because it would be a speculation on an hypothetical and non-existent contract, and thus a violation of the parties' will. Moreover, it may be difficult to evaluate expectation damages because, sometimes, essential terms have not been negotiated.

The French law of torts requires two conditions for the damage to be compensated: the concerned damage must be certain and not otherwise compensated. According to

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[363] *Contract in a nutshell*, 3rd ed., ***supra*** note 193 at 241.

[364] N.E.Nedzel, ***supra*** note 319 at 147.

[365] *Contract in a nutshell*, 3rd ed., ***supra*** note 193 at 104

[366] ***Ibid.*** at 242.

[367] N.E.Nedzel, ***supra*** note 319 at 133.

Article 1149 of the Civil Code, the present loss (*damnum emergens*) and the missed gain (*lucrum cessans*) have to be considered and compensated.[368]

In case of breach of negotiations, the damage may consist of loss of time, expenditures incurred by the negotiations or the missed gains.[369] Loss occurred at the pre-contractual stage is evaluated on case-by-case basis. The method used by the courts to assess the prejudice is not clear because the courts usually do not outline the elements that have served to appraise the damages.[370] The amount of damages is sovereignly evaluated by the lower courts. It is a factual issue that does not concern the competencies of the *Cour de cassation*.[371]

The amount of damages is limited by the terms of the agreement or by the foreseeable prejudice.[372] The party cannot exclude or limit the possible compensation in their preliminary agreement. Compensation is a compulsory legal rule.[373]

In American law, expectation damages require certainty and foreseeability.[374] American courts are divided on the issue of awarding expectation or reliance damages in a

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[368] Article 1149: "Les dommages et intérêts dus au créancier sont, en général, de la perte qu'il a faite et du gain dont il a été privé, sauf les exceptions et modifications ci-après."

[369] J.Schmidt-Szalewski, ***supra*** note 20 at 149.
Bodily injuries occurring during precontractual negotiations are also compensated in torts. For instance, the *cour de cassation* awarded damages to a deliverer that had been injured while spontaneously helping the client to move a piece of furniture.
Cass.civ.II, 15 Feb. 1984: Bull.civ II, No.29; Rev.tr.dr.civ., 1985, p.389, note Huet.

[370] J.Schmidt-Szalewski, ***supra*** note 20 at 152.

[371] Cass. crim. 3 December 1969, J.C.P. 1970, II, 16353.

[372] According to Article 1150 of the civil code, damages are limited to the foreseeable prejudice.
Article 1150: "Le débiteur n'est tenu que des dommages et intérêts qui ont été prévus ou qu'on a pu prévoir lors du contrat, lorsque ce n'est point par son dol que l'obligation n'est point exécutée."

[373] J. Schmidt-Szalewski, "La période précontractuelle", (1990) R.I.D.C. 545, at 554.

preliminary agreement situation. They consider that expectation damages cannot be recovered because no reasonable expectations have been created.[375] On the other hand, courts may also not admit reliance damages because of the incompleteness of an agreement.[376]

Because of the absence of a final contract, Professor Farnsworth notes that pre-contractual liability cannot support expectation damages.[377] Only the expenses incurred during the negotiations can be compensated in case of breach of preliminary agreement. He argues that as there is "no way of knowing what the terms of the ultimate agreement would have been, or even whether the parties would have arrived at an ultimate agreement."[378] He adds that "there is no possibility of a claim for lost expectation under such an agreement."[379]

On the contrary, Burton and Andersen observe that in many cases "it is practical and appropriate to allow expectation damages based on the potential, but unrealized, final contract."[380] In order to determine the economic loss, Burton and Andersen explain that "when the parties have worked out many of the principal economic terms of their final

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[374] *Contract in a nutshell*, 3rd ed., ***supra*** note 193 at 251.

[375] See ***e.g.***, *Air Technology Corp. v. General Elec. Co.*, 347 Mass. 613, 199 N.E.2d 538 (1964).

[376] See ***e.g.***, *Wright v. United States Rubber Co.*, 280 F.Supp. 616 (D. Ore. 1967).
However, in the case *Stewart v. Schmauss*, the plaintiff recovered reliance damage whereas the agreement was not binding.
Stewart v. Schmauss, 191 So. 2d 882 (La. Ct. App. 1966).

[377] See, E.A. Farnsworth, ***supra*** note 47 at 223.

[378] ***Ibid.***

[379] ***Ibid.***

[380] S.J. Burton and E.G. Andersen, ***supra*** note 18 at 364-366.

contract in detail, there is no obstacle to allowing expectation damages based on the bargain tentatively agreed to, but not consummated."[381] In cases dealing with a loan agreement,[382] a commercial lease,[383] and a manufacturing contract,[384] the courts have granted expectation damages for the breach of a preliminary agreement.[385]

The French courts award compensation for loss of opportunities. In case of failure of negotiations, the loss of an opportunity (*perte d'une chance*) is characterized by the loss of an opportunity to conclude the contract with a third party. This theory is applicable to all compensation in torts. The appraisal of the loss of chance is a factual question left to the lower courts.[386] Because of the uncertain result of the negotiations, the court cannot consider the hypothetical final contract and can only compensate a loss of an opportunity.

To award compensation for the loss of an opportunity, the plaintiff has to clearly demonstrate that he had the opportunity to conclude a similar contract with another party. For instance, in a case of 1987, the manager of a corporation was not able to continue negotiations, due to a traffic accident. The corporation claimed compensation from the

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[381] ***Ibid.***

[382] See ***e.g.***, *Teachers Ins. & Annuity Ass'n of Am.* v. *Coaxial Communications, Inc.*, 799 F. Supp. 16, 18-19 (S.D.N.Y. 1992); *Teachers Ins. & Annuity Ass'n of Am.* v. *Ormesa Geothermal*, 791 F. Supp. 401, 415-18 (S.D.N.Y. 1991); *Teachers Ins. & Annuity Ass'n of Am.* v. *Butler*, 626 F. Supp. 1229, 1236 (S.D.N.Y. 1986). All those cases award expectation damages for breach of a loan commitment.

[383] See ***e.g.***, *Evans, Inc.* v. *Tiffany & Co.*, ***supra*** note 131 at 240-45. (awarding expectation damages for breach of a preliminary agreement to enter into a commercial lease).

[384] See ***e.g.***, *Milex Prods., Inc.* v. *Alra Lab., Inc.*, 603 N.E.2d 1226, 1235-37 (Ill. App. Ct. 1992) (awarding expectation damages for breach of a preliminary agreement to enter into a manufacturing contract).

[385] S.J. Burton and E.G. Andersen, ***supra*** note 18 at 364-366.

[386] J. Schmidt-Szalewski, ***supra*** note 160 at 95.

author of the accident, for the damage consisting in the non-conclusion of those contracts. The action was dismissed, because the damage was too hypothetical.[387]

2. The refusal of specific performance

In French and American law, the non respect of a contract to negotiate cannot lead to specific performance, *i.e.*, to the forced execution of the obligation to negotiate. A forced negotiation would have no chance to succeed.

The judge cannot go beyond the parties' will and cannot draft the final contract for the parties. A contract to negotiate leads to a final contract only if the negotiations succeed.[388] Besides, Article 1142 of the Civil Code provides that specific performance is prohibited for personal services (*obligation de faire*).[389]

In American law, specific performance requires a sufficient certainty of the contract.[390] Thus, specific performance is not an appropriate remedy in a preliminary agreement situation. Besides, the execution of a contract that is still in negotiation would lead to the non respect of the parties' intention.[391]

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[387] Cass.civ.II. 12 June 1987: J.C.P. 1987. IV. 286; Rev.tr.dr.civ., 1988. p.103. obs. Mestre.
J.Schmidt-Szalewski. ***supra*** note 20 at 149.

[388] J.Schmidt. ***supra*** note 16 at 207-208.

[389] Article 1142: "Toute obligation de faire ou de ne pas faire se résout en dommages et intérêts. en cas d'inexécution de la part du débiteur."
J. Schmidt-Szalewski. ***supra*** note 160 at 155-156.

[390] Restatement (Second) of Contracts § 362 (1981).

[391] H.L. Temkin. ***supra*** note 296 at 163.

3. Damages for breach of a good-faith obligation

In France and in the United States, an unjustified termination of negotiations may lead to damages when the preliminary agreement includes an obligation to make good faith efforts to achieve a final contract.[392] For instance, in the American case *Gray Line of Boston, Inc. v. Sheraton Boston Corp.*,[393] the court awarded damages because of a breach of a promise to negotiate in good faith.[394]

In the context of an agreement to negotiate, the only appropriate remedy for the breach of a good-faith obligation is reliance damages. Those damages are the ones caused by the injured party's reliance on the agreement to negotiate.[395] In French and American law, damages must be proved with reasonable certainty which may be difficult because of the lack of essential terms and the possible indefiniteness of the agreement.[396] The indefiniteness of the preliminary agreement may be an obstacle to obtain damages.

In his criticism of the *Penzoil* case,[397] Professor Farnsworth has fictitiously transposed the facts in a European civil law system.[398] First, Penzoil would have sued

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[392] *Contract in a nutshell*, 4th ed., ***supra*** note 200 at 69

[393] *Gray Line of Boston, Inc. v. Sheraton Boston Corp.*, 62 B.R. 811 (Bankr. D. Mass. 1986).

[394] A few courts have decided that a breach of an implied good-faith obligation could support a claim for emotional distress or punitive damages.
See, ***e.g.***, *Wallis* v. *Superior Court*, 207 Cal. Rptr. 123 (Cal. Ct. App. 1984); *Cleary* v. *American Airlines*, Inc., 168 Cal. Rptr. 722 (Cal. Ct. App. 1980); *Gates*, 668 P.2d 213; *Ponsock*, 732 P.2d 1364.
R.J. Mooney, ***supra*** note 86 at 1179.

[395] E.A. Farnsworth, ***supra*** note 47 at 267.

[396] C.L. Knapp, ***supra*** note 15 at 723.

[397] In the *Penzoil* case, the Texas court of first instances granted almost US $11 billion to Penzoil, including an award of punitive damages of $ 3 billion. In 1988, the Texas Court of Appeals admitted that the parties were bound by the agreement in principle but reduced the amount of punitive damages to one billion. Twenty-five

Getty rather than Texaco. This action would have been grounded either on the non-respect of the preliminary agreement or on the breach of a duty of good faith.[399] Second, damages would have either consisted in the amount of loss expectations for the breach of the preliminary agreement or, based on the breach of the duty of good faith, in the amount of expenses incurred during the negotiations and compensation for lost opportunities.[400] In France, if the partial agreement is found to be the final contract, the non performance of this partial agreement leads to damages pursuant to Article 1142 of the Civil Code.[401] In this situation, the parties go from the negotiation phase to the performance phase, without materialisation of the final contract.[402]

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months later. the two companies agreed to a settlement. Texaco paid US $3.000 million in cash to Penzoil to end the dispute.
Pennzoil, ***supra*** note 243.

[398] A.E Farnsworth, ***supra*** note 241 at 239-242.

[399] See. E.A. Farnsworth, ***supra*** note 47 at 239-42.

[400] See ***ibid.*** at 223-29.

[401] Article 1142: " Toute obligation de faire ou de ne pas faire se résout en dommages et interêts. en cas d'inexécution de la part du débiteur."

[402] J-M. Loncle and J-Y Trochon, ***supra*** note 11 at 12.

Those procedures would have avoided the long and complex actions endured by Penzoil.

The recognition of an implied duty to negotiate in good faith facilitates the awarding of damages. The party who has suffered the prejudice has only to demonstrate the bad faith behavior of the blameworthy party and its consequences. The demonstration of the existence of a duty to negotiate in good faith is not at stake.

CONCLUSION

The usefulness of letters of intent in business negotiations is unquestionable.

In France and in the United States, preliminary agreements play a key role in the recognition of parties' rights.

Even if the preliminary agreement is not binding, it may serve to demonstrate the state of mind of the parties at the moment of the negotiations. A letter of intent shows a greater commitment of the parties to negotiate seriously to reach a final contract than no letter at all. It may also serve to evidence an incorrect breaking off.[403]

In American cases, like the *Penzoil* case and the *Arcadian* case, the court would have not taken into account the damages suffered by Penzoil and would have not imposed a duty of good faith on Arcadian corp.[404] without preliminary agreements. The existence of a preliminary agreement was primordial.

At the beginning of the negotiations, parties are preoccupied by respective performances and not by potential liability.[405] Nonetheless, the importance of preliminary agreements in complex negotiations and the major risks of pre-contractual liability that may arise from the lack of clarity in letter of intent justify that lawyers should not be

[403] J.Cedras, "L'obligation de négocier", (1985) Rev. Trim. Dr. Com., at 265.

[404] ***Ibid.***

[405] R.B.Lake and U.Draetta, ***supra*** note 1 at 10.

excluded from the drafting process at the beginning of the negotiations.[406] A letter of intent properly drafted does not have unexpected consequences and its binding effect, in part or entirely, reflects the parties' will.[407]

Unclear drafting and divergent intentions give rise to unexpected interpretations. Parties may be bound by pre-contractual agreements, without having wanted such a result, because of the indefiniteness and vagueness of the terms. The importance and the complexity of today's transactions may reinforce the idea that a letter of intent and other preliminary documents intend to be preliminary only.[408] However, in France and in the United States, the more specific are the terms contained in the preliminary agreement, the more likely the document will be enforced as a final contract, unless the parties have clearly stated the contrary.[409]

The difficulties to tackle letters of intent under contract law are primarily due to their hybrid legal nature induced by their multiple purposes. French and American contract law basically consider the existence of an offer and the acceptance of this offer. However, the classical doctrine of offer and acceptance does not reflect the complex and technical contemporary business practices, specifically the negotiation phase of elaborate agreements.

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[406] R.B.Lake, ***supra*** note 13 at 353.

[407] R.B.Lake and U.Draetta, ***supra*** note 89 at 835.

[408] A.L.Corbin, revised edition by J.M.Perillo, ***supra*** note 216 at 152.

[409] S.J. Burton and E.G Andersen, ***supra*** note 18 at 362.

The contemporary evolution of contract formation is illustrated by the growing number of parties involved in negotiations; whatever the size of the corporation, several persons will be sent to the negotiation table: executives, experts, lawyers, accountants and so on. It is also explained by the growing number of intermediary documents that are signed before the final contract. In sophisticated transactions, the parties record their consents step by step in pre-contractual documents before the finalization of the contract.[410] The increase complexity of business transactions has given rise to a new way to tackle contract formation for lawyers and business persons.

In Farnsworth's words, "the law governing the formation of contracts, however suited these rules may have been to the measured cadence of contracting in the nineteenth century... have little to say about the complex processes that lead to major deals today."[411]

Contract law cannot be restricted to the final agreement and its performance. It is necessary that the pre-contractual period as well as the pre-contractual documents be considered by contract law.

Finally, in preliminary agreement situations, the main issue at stake is whether or not the parties have entered a formal agreement during the negotiation phase. The thesis demonstrates that, in France and in the United States, whenever the existence of a final

[410] E.A. Farnsworth, ***supra*** note 47 at 218-219.

[411] ***Ibid.***

contract is recognized, based on the parties' intent and behavior, it is because circumstances have created a legitimate reliance that worth protection by courts or legislation.[412]

[412] J.Schmidt-Szalewski, *supra* note 20 at 156-157.

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